United States Court of Appeals

for the Second Circuit

JOINT APPENDIX

76-7156

B

P/S

United States Court of Appeals

FOR THE SECOND CIRCUIT

MILDRED GALFAND, on behalf of herself and on behalf of AMERICAN INVESTORS FUND, INC.,

Plaintiff and Cross-Appellant,

—against—

CHESTNUTT CORPORATION,

Defendant-Appellant,

—and—

AMERICAN INVESTORS FUND, INC.,

Nominal Defendant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES COURT OF APPEALS
FILED
AUG 2 1976
A. DANIEL FUSARO, CLERK
SECOND CIRCUIT

JOINT APPENDIX

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PAGINATION AS IN ORIGINAL COPY

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CIVIL DOCKET
UNITED STATES DISTRICT COURT

73 CIV. 3849

Jury demand date:

WIDOW APPLICANT

J. C. Form No. 106 Rev.

TITLE OF CASE	ATTORNEYS
MILDRED GALFAND, on behalf of herself and on behalf of AMERICAN INVESTORS FUND, INC. vs GEORGE A. CHESTNUTT, JR., CHESTNUTT CORPORATION, AND AMERICAN INVESTORS FUND, INC. 7-26-74	For plaintiff: Kreindler & Kreindler 99 Park Ave., NY 10016 687-8 For defendant: Rogers Hoge & Hills 90 ~~Park Ave., NY 10016 - 953-9200~~ American Investors Fund. 8-12-75 Rogers & Wells Esqs 200 Park Ave., NYC 10017 972-7000

STATISTICAL RECORD	COSTS	DATE	NAME OR RECEIPT NO.	REC.	DISB.
J.S. 5 mailed	Clerk		TRANSF.		
J.S. 6 mailed √	Marshal				
Basis of Action: S.E.C. ACT of 1934	Docket fee				
	Witness fees				
Action arose at:	Depositions				

BEST COPY AVAILABLE

MILTON BRIANT, III vs C. A. CHESTNUTT, JR. 72 C 30[illegible] CLD

DOCKET

DATE	FILINGS—PROCEEDINGS	CLERK'S FEES		AA RCHC EMO RE
		PLAINTIFF	DEFENDANT	
7-2 -75	Filed Findings and Conclusions #2839.... Conclusion: counsel are requested to submit a stip. in writing setting forth the applicable amounts in accordance with the opinion, or if such a stip. cannot be mutually agreed upon, so to advise the Court within 20 days from this date hereof so consideration may be given as to how such data may be elicited....The foregoing constitutes findings of fact and conclusions of law pur. to Rule 52(a) F.R.C.P. Stewart,J.			
8-12-75	Filed Stip. & Order of Consent to Change Attys for deft, American Investors Fund to ROGERS & WELLS in place and stead of Rogers, Hogg, & Hills....Stewart,J.			
9-26-75	Filed Memo Re: Damages Submitted on behalf of Counsel for American Investors F			
9-26-75	Filed Pltff's Affvt by B. Brewster...in support of pltff's argument Re:72 & 73 Rebate.			
9-26-75	Filed Pltff's Memo in Support of it's damage Portion.			
11-11-75	Filed supplemental & corrected findings & conclusions & Order #42839. Prior findings & conclusions filed on 7-23-75, are modified & amplified as indicated. Settle a final judg on 5 days notice in favor of American Investors Fund, Inc. against Chestnutt Corp. in the amount of $76,672.00. The judgment may contain appropriate provisions retaining jurisdiction to award legal fees & disbursements to pltff-out of the recovery following appellate finality, & upon notice.. BRIEANT,J m/n			
12-[illegible]-75	[illegible] dtd 11-[illegible]-75.			
12-[illegible]-75	[illegible] to Judge Brieant.			
1-[illegible]-7[illegible]	[illegible] Investors Fun			
	[illegible]			
	[illegible]			
	[illegible]			
	[illegible]			
2-24-76	Fld Memo And on motion fld 2-23-76.....The Court declines to entertain any fu quests for corrections, additions or refinements to the Judgment, or to do an thing further in this action. and respectfully commends these indefatigable b inexact litigants to the Court of Appeals for such directions as it may wish to make in the matter...So Ordered....Brieant, mn			

73 Civ. 3849 Mildred Gelfand, etc. -v- George A. Chestnutt 73 CIV. 3849

DATE	PROCEEDINGS	Date Order Judgment
7-73	Filed certified copy of docket entries and order of transfer from the Eastern District of Pennsylvania together with all filed papers.	
	PROCEEDINGS - Cont'd	
9-73	Filed notice of appearance that Kreindler & Kreindler hereby appear as atty's for Mildred Gelfand.	
20-73	Filed stip. & order extending defts' time to answer to 11-21-73--Brieant,J.	
19-73	Filed ANSWER and counterclaim of defts.	
11-73	Filed pltffs notice of motion to dismiss first & second counter-claims. Ret. 12-20-73.	
11-73	Filed pltffs memo in support of motion.	
3-74	Filed MEMO END on motion filed Dec.11-73. Motion Granted on consent and counter-claims are dismissed. Such dismissal is without prejudice and Rule 41 F.R. Civ.P. So Ordered. BRIEANT,J.	
8-74	Filed pltff's Interrogatories.	
8-74	Filed pltff's request for production of documents.	
5-74	Filed Pltff's Notice of Motion for leave to file amended complaint ret. Jun 26,74	
18,74	Filed Pltff's Memo of Law in support of Pltff's motion to amend the complaint.	
22-74	Filed defts affdvt & notice of motion to dimiss the complt. Ret. 7-24-74.	
22-74	Filed defts memo in support of motion to dismiss.	
23-74	Filed pltffs memo in opposition to defts motion.	
26-74	Filed Memorandum & Order. Defts motion to dismiss the complt is granted, & complt is dismissed without prejudice to the rights of American Investors Fund, Inc. Pltffs motion for leave to serve an amended complt is granted on condition that amended pleading is verified, served & filed within 90 days from date hereof, if pltff desires to proceed with her litigation. At or prior to such filing pltff shall file in this Court an original bond for costs of this action in the am't of $1,000. BRIEANT,J. m/n	
2-74	Filed Bond for Undertaking for Costs in sum of $1000, as to defts George A.Chestnutt, & Chestnutt Corp. - Fidelity & Deposit Co.	
14-74	Filed pltffs verified amended complt. with Rider to the undertaking for costs. - Fidelity & Deposit Co. of Maryland - $1000.	
30-74	Filed Defts, George A. Chestnutt, Jr., Chestnutt Corp. and American Investors Fund, Inc's ANSWER TO Verified Amended Complaint.	RS
19-75	Filed Consent Pre-Trial Order...Brieant,J.	
19-75	Filed Stip & Order that the listed facts are true and require no proof for the purposes of this action only...Brieant,J.	
	[illegible]	
	[illegible]	
11-75	Filed Pltff's Post-Trial Reply Meo.	
15-75	Filed Pltff's Proposed Findings of Fact & Conc. of Law.	
15-75	Filed pltff's Post-Trial Memo.	
15-75	Filed Defs. Post Trial Memo.	
15-75	Filed Defts. Post-Trial Reply Memorandum.	
	Filed transcript of record of proceedings dated [illegible]	
21-75	Filed pltff's Designation of Documents for use at trial.	
21-75	Filed pltff's Trial Memorandum.	
21-75	Filed Defts Trial Memorandum.	
	[illegible]	

Galfand Vs Chestnutt Jr 73 Cr 3849 CLB Page 4

DATE	PROCEEDINGS	CLERK'S FEES		AMOUNT REPORTED IN EMOLUMENT RETURNS
		PLAINTIFF	DEFENDANT	
-22-76	Fld Deft Chestnutt Corp's Not. of Appeal to USCA from Final Judg ent 12-17-75..Copies mailed on 3-24-76 to:Kreinlder & Kreindler Esqs. & Rogers & Wells Esq.			
25-76	Fld M.Galfand Notice of Appeal(cross) from order 2-24-76/ Notice mailed on 3-26-76 to Rogers, Roge & Wills & Rogers &Wells.			

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
----------x

MILDRED GALFAND,

Plaintiff,

-against-

GEORGE A. CHESTNUTT, JR.,
CHESTNUTT CORPORATION,
AMERICAN INVESTORS FUND, INC.,

Defendants.

----------x

73 Civ. 3849 (CLB)

VERIFIED AMENDED COMPLAINT

Plaintiff, by her attorneys, for her complaint alleges upon information and belief, except as to paragraphs 3, 4, 5 and 9 which are alleged on knowledge:

JURISDICTION

1. This Court has jurisdiction of this action pursuant to Section 44 of the Investment Company Act of 1940 (15 U.S.C. §80a-43) (the "Act"), Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. §78aa) (the "Exchange Act"), and upon the principles of pendent jurisdiction.

2. This action arises under the Act, the Exchange Act, and the common law.

RULE 23.1 F.R.C.P. ALLEGATIONS

3. Plaintiff is a shareholder of defendant, American Investors Fund, Inc. ("AIF") and has been such since prior to the time of the transactions complained of herein.

4. Plaintiff brings this action derivatively on AIF's behalf.

5. This action is not brought collusively to confer upon this Court jurisdiction which it otherwise would not have.

6. Demand upon AIF's directors to bring this action would be futile and is unnecessary since:

(a) the alleged wrongdoers control and dominate AIF and its board of directors;

(b) the directors participated or acquiesced in wrongful conduct herein alleged;

(c) the institution of this action by AIF would place the action in hostile hands and would prevent its effective prosecution.

7. Demand upon AIF's shareholders to bring this action would be futile and is unnecessary since:

(a) Under the laws of New York, under which AIF is incorporated, AIF's shareholders cannot by resolution or otherwise require AIF to bring an action;

(b) Even if the shareholders were to direct that a suit be instituted, suit could only be instituted by AIF through its board of directors, which is controlled and dominated by the alleged wrongdoers.

8. Furthermore, demand upon AIF's directors or shareholders is unnecessary since plaintiff is specifically empowered to bring this action without making such demand by Section 36(b) of the Act (15 U.S.C. §80a-35(b)).

PARTIES

9. Plaintiff is, and at all times relevant was, a shareholder of AIF.

10. AIF, a nominal defendant, is a "no-load" mutual fund registered pursuant to the Act as an open-end diversified investment company. AIF's principal office is located in Greenwich, Connecticut.

11. Defendant, Chestnutt Corporation, a closely held corporation, has acted as investment adviser to AIF at all times relevant to this action.

12. Defendant, GEORGE A. CHESTNUTT, JR. is and at all times relevant was president and a director of AIF. Chestnutt also is and at all times relevant was the principal shareholder, a director and president of Chestnutt Corporation.

FOR A FIRST CLAIM

13. Chestnutt Corporation, or its predecessor, had continuously served as investment adviser to AIF from AIF's formation in 1957 through the date hereof.

14. Chestnutt Corporation owed fiduciary duties to AIF by reason of their relationship and by specific provision of Section 36 (b) of the Act (15 U.S.C. §80a-35(b)) which provides:

> "...the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services..."

15. On or about May 1973 Chestnutt Corporation was serving as investment adviser to AIF under an investment advisory agreement made as of September 1, 1972 ("Old Advisory Agreement"). The term of the Old Advisory Agreement was for two years.

16. At the time the Old Advisory Agreement became effective, AIF's net assets were approximately $220,000,000.

17. Under the terms of the Old Advisory Agreement, Chestnutt Corporation agreed to provide AIF, among other things:

(a) research, statistical and advisory services and assistance and guidance in the administration of AIF's assets;

(b) office space and in connection therewith all utilities, office supplies and stenographic, clerical, mailing and messenger service; and

(c) payment of all AIF's executive salaries and payment of all promotional, travel and entertainment expenses relating to AIF's sales.

18. Payment to Chestnutt Corporation by AIF under paragraph 9 of the Old Advisory Agreement was the amount obtained by applying the following quarterly rates to the value of AIF's net assets at the end of each calendar quarter:

Quarterly Rate	Equivalent Annual Rate	Net Assets of the Corporation
0.2 of 1%	0.8 of 1%	on the first $ 50 million
0.15 of 1%	0.6 of 1%	on the next $ 50 million
0.1 of 1%	0.4 of 1%	on the next $200 million
0.0875 of 1%	0.35 of 1%	on the next $200 million
0.075 of 1%	0.3 of 1%	on net assets in excess of $500 million

19. The advisory fee under the Old Advisory Agreement, however, was subject to a 1% expenses limitation ("expense limitation"). The expense limitation of the Old Advisory Agreement read as follows ("Corporation" referring to AIF and "Investment Adviser" referring to Chestnutt Corporation):

> "provided, however, that the annual fee of the Investment Adviser shall not be more than an amount which when added to the other charges of the Corporation (exclusive of interest and taxes), shall result in total charges per annum to the Corporation inclusive of the fee of the Investment Adviser (but exclusive of interest and taxes) of 1% of the value of the Corporation's average monthly net assets for any year."

The payments under the Old Advisory Agreement, subject to the expense limitation, were to be calculated as of July 1, 1972 by a specific provision of paragraph 9 of said agreement.

20. The effect of the expense limitation was that if AIF's expenses (exclusive of interest and taxes) for any year under the Old Advisory Agreement exceeded 1% of AIF's average monthly net assets, Chestnutt Corporation would be obligated to credit or refund to AIF such excess.

21. By May 1973 the per share value of AIF shares had declined in value - also the net asset value of AIF was down to $150,000,000 from the $220,000,000 value on or about September 1, 1972, when the Old Advisory Agreement became effective. The decrease in AIF's net assets were due, at least in part, to (a) Chestnutt Corporation's investment advice to AIF which resulted in a declining per share value for AIF shares, and (b) increased redemptions by AIF shareholders due to shareholder dissatisfaction with the performance of AIF and Chestnutt Corporation.

22. By May 1973 AIF's expenses that were subject to the 1% expense limitation were declining in comparison to 1972. Accordingly, AIF expenses, exclusive of interest and taxes, were as follows:

	1973	1972
1st Quarter	$431,160.21	$539,680.47
2nd Quarter	$428,058.26	$532,477.64

Furthermore, AIF's annual expenses, exclusive of taxes and interest, had declined from $2,213,814 in 1971 to $2,009,122 for 1972. AIF's expenses, exclusive of taxes and interest, further declined in 1973 to $1,693,249.

23. For at least the period of six years prior to May 1973 AIF had performed relatively poorly. According to Fundscope, a leading publication relating to mutual funds, for the period January 1, 1967 to December 31, 1971 AIF had performed the absolute worst among 206 reporting mutual funds. According to Fundscope a $10,000 investment in AIF on January 1, 1967 would be worth $8,498 on December 31, 1971. During this same period, according to Fundscope, a similar investment in the Neuwirth fund would have grown to $57,895. Also, according to the same Fundscope study, only 8 of the 206 funds, including AIF, managed to lose money during this 5-year period.

During calendar year 1972, the Dow Jones Industrial average increased 14.6% while AIF increased only 10.4%.

24. In May 1973, because AIF's net assets had dropped as indicated, there was a reasonable expectation that AIF's expenses would exceed the 1% expense limitation giving rise to the credit or refund to AIF.

25. In June 1973 because of the likelihood of the credit or refund to AIF by reason of the 1% expense limitation, defendant George A. Chestnutt, Jr. used his influence over the AIF Board to cause the AIF Board to recommend to AIF shareholders that the Old Advisory Agreement be replaced in mid-term by a new advisory agreement idential in all respects except for a 1-1/2% expense limitation in place of the 1% expense limitation ("New Advisory Agreement").

26. The AIF Board dominated and controlled by George A. Chestnutt, Jr. voted for the New Advisory Agreement and approved the issuance of a proxy statement dated June 21, 1973 covering a shareholder vote on the new contract to be held at a meeting July 17, 1973 ("Proxy Statement").

27. The AIF shareholders, on or about July 17, 1973, voted affirmatively for the New Advisory Agreement by means of proxies solicited with the Proxy Statement.

28. The New Advisory Agreement has been put into effect and as a result thereof AIF has been deprived of credits or refunds to which AIF would be entitled under the Old Advisory Agreement.

29. For the three calendar quarters that have elapsed since the effective date of the New Advisory Agreement, AIF's expenses (exclusive of taxes and interest) have exceeded 1% of average monthly net assets. AIF's expenses for calendar year 1973 also exceed the 1% expense limitation.

30. The replacing of the Old Advisory Agreement with the New Advisory Agreement constituted a breach of fiduciary duty by Chestnutt Corporation and the AIF Board of Directors for which Chestnutt Corporation and George A. Chestnutt, Jr. are liable to AIF under Section 36(b) of the Act (15 U.S.C. §80a-35(b)) and principles of common law.

31. The breach of fiduciary duty under the Act and common law resulted since:

(a) a benefit for AIF was given up for which no consideration was received when the New Advisory Agreement was recommended and approved by the AIF Board;

(b) the sole purpose of the New Advisory Agreement was to benefit George A. Chestnutt, Jr. and Chestnutt Corporation at the expense of AIF;

(c) the New Advisory Agreement was approved by the AIF Board in violation of Section 15(c) of the Act (15 U.S.C. §80a-15(c)) in that information reasonably

necessary to an evaluation of the New Advisory Agreement

(i) was not requested by the AIF Board;

(ii) was not evaluated by the AIF Board;

(iii) was not furnished by Chestnutt Corporation to the AIF Directors

(d) The Proxy Statement used to solicit votes for the New Advisory Agreement was issued in form that the AIF Board knew and defendants George A. Chestnutt, Jr. and Chestnutt Corporation knew, or should have known, to be false and misleading in the respects set forth below.

32. As a result of the foregoing, AIF has been damaged, Chestnutt Corporation and George A. Chestnutt, Jr. have been enriched, and Chestnutt Corporation and George A. Chestnutt, Jr. are liable to AIF therefor in an amount that will be determinable after June 30, 1974.

FOR A SECOND CLAIM

33. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1 through 32.

34. The Proxy Statement used to solicit AIF shareholder approval for the New Advisory Agreement was materially false and misleading in violation of Section 14 of the Exchange Act in that it:

(a) failed to state that the fee paid by AIF to Chestnutt was higher than chat paid by most other funds. A statement to this effect was omitted from the Proxy Statement despite the S.E.C.'s specific request for the inclusion of such statement;

(b) stated (p. 6) that "cost increases over which neither the Fund nor the Adviser can exercise control" was the principal reason for the requested increase when

in fact the primary, if not exclusive reason, for the requested increase was the declining net asset base of AIF that was about to bring about a credit or refund to AIF at the expense of Chestnutt Corporation;

(c) failed to indicate that at the then current rate of expense and level of AIF net assets, AIF would receive a credit or refund from Chestnutt Corporation under the existing 1% expense limitation;

(d) implied that no credit or refund would be likely with the continued 1% expense limitation by a reference to 1972 results at a time when current results were available and indicated that, in fact, a credit or refund was likely;

(e) failed to indicate how poorly AIF had performed with Chestnutt Corporation as investment adviser;

(f) failed to disclose the profits derived by Chestnutt Corporation during the course of past advisory agreements with AIF;

(g) failed to disclose the salaries paid to officers of AIF by Chestnutt Corporation;

(h) failed to disclose the salaries and other financial benefits received by George A. Chestnutt, Jr. as a result of the relationship of Chestnutt Corporation and AIF.

35. By reason of the foregoing, defendants Chestnutt Corporation and George A. Chestnutt, Jr. have wrongfully benefited and profited at the expense of, and to the detriment of, AIF and its shareholders in an amount that will be determinable after June 30, 1974.

WHEREFORE, plaintiff prays for judgment:

(a) voiding the New Advisory Agreement;

(b) requiring defendant Chestnutt Corporation and George A. Chestnutt, Jr., jointly and severally, to account to AIF and its shareholders as if the Old Advisory Agreement had not been terminated;

(c) allowing plaintiff the costs and expenses of this action, including reasonable counsel fees; and

(d) granting such other and further relief as may be just.

KREINDLER & KREINDLER
Attorneys for Plaintiff

By _____

Office and P. O. Address
99 Park Avenue
New York, New York 10016
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OF COUNSEL:

LYMAN AND ASH
1612 Latimer Street
Philadelphia, Pennsylvania 19103

VERIFICATION

STATE OF NEW JERSEY)
: ss.:
COUNTY OF ATLANTIC)

MILDRED GALFAND, being duly sworn, deposes and says that she is the plaintiff in the within action, that she has read the foregoing Verified Amended Complaint and knows the contents thereof; that the same is true to her own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters she believes it to be true.

Mildred Galfand

MILDRED GALFAND

Sworn to before me this
12th day of August, 1974

Notary Public

NOTARY PUBLIC OF NEW JERSEY
My Commission Expires Oct. 23, 1977

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MILDRED GALFAND,	:	
Plaintiff,	:	73 Civ. 3849 (CLB)
-against-	:	
GEORGE A. CHESTNUTT, JR., CHESTNUTT CORPORATION, AMERICAN INVESTORS FUND, INC.,	:	ANSWER TO VERIFIED AMENDED COMPLAINT
Defendants.	:	

Defendants GEORGE A. CHESTNUTT, JR., CHESTNUTT CORPORATION and AMERICAN INVESTORS FUND, INC., answering the Verified Amended Complaint herein, allege as follows with respect to the paragraphs numbered correspondingly of the Verified Amended Complaint:

1 and 2. Deny the allegations of paragraphs 1 and 2.

3. Admit the allegations of paragraph 3.

4 and 5. Deny knowledge or information sufficient to form a belief as to the truth of the allegations of paragraphs 4 and 5.

6 through 8. Deny the allegations of paragraphs 6 through 8, except admit that shareholders cannot require AIF to bring an action.

9 through 12. Admit the allegations contained in paragraphs 9 through 12.

WITH RESPECT TO THE ALLEGED FIRST CLAIM

13. Admit the allegations of paragraph 13.

14. Admit The Investment Company Act of 1940 contains the excerpt quoted in paragraph 14 and respectfully refer to the entire Act for a statement of the extent to which its provisions relate to the alleged "fiduciary duties".

15. Admit the allegations of paragraph 15 and allege that the "Old Advisory Agreement" referred to therein was for a two-year term commencing July 1, 1972.

16. Admit the allegations of paragraph 16.

17 through 20. Deny that the allegations contained in paragraphs 17 through 20 fully and fairly allege the provisions of said Old Advisory Agreement and respectfully refer the Court to said Agreement in its entirety for a full and complete statement thereof.

21. Deny the allegations contained in paragraph 21 and allege that the period of time referred to was one of sharply declining stock prices during which same period of time investment companies in general sustained substantial net redemptions of shares in excess of shares sold to the public.

22. Deny that the allegations with respect to AIF's expenses or the computation thereof are fully and fairly set forth and respectfully refer to the published audited financial statements for the calendar years 1971, 1972 and 1973 for a full and complete statement thereof; deny that expenses for any particular alleged quarterly period, as such, are cognizable under either the Old or the New Advisory Agreement; and allege that no computation of expenses under either the

Old Advisory Agreement or the New Advisory Agreement could be made until after the close of each calendar and fiscal year.

23. Deny knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 23 and deny any implication that the investment record of AIF has been relatively or generally poor or that eclectic allegations with respect to any particular period afford a reasonable basis for judging investment performance.

24. Deny the allegations of paragraph 24.

25. Deny the allegations of paragraph 25 and allege that in accordance with AIF's invariable practice each year to present to shareholders a New Advisory Agreement, AIF's Board of Directors in the exercise of their discretion recommended that a New Advisory Agreement be approved containing an expense limitation as defined therein of 1 1/2%.

26. Deny the allegations of paragraph 26 except admit that the AIF Board of Directors approved the issuance of a proxy statement containing a proposed New Investment Advisory Agreement to be approved or rejected by shareholders at a meeting to be held July 17, 1973, and as set forth in said proxy statement in the event of shareholder rejection the alleged Old Advisory Agreement would continue in effect.

28. Deny the allegations of paragraph [illegible] except admit the New Advisory Agreement was entered into following shareholder approval.

29. Deny that there was any alleged "1% expense limitation" for the calendar year 1973, and allege that for the first half of such calendar year there was an expense limitation as defined in the Agreement of 1% and for the second half of the calendar year commencing July 1, 1973 there was an expense limitation of 1 1/2% as approved by the shareholders of AIF all of which could be determined only after December 31, 1973, and deny the applicability of either expense ratio to any particular calendar quarter, and except as expressly admitted herein deny each and every other allegation contained in paragraph 29.

30. Deny the allegations of paragraph 30.

31. Deny the allegations of paragraph 31.

32. Deny the allegations contained in paragraph 32.

WITH RESPECT TO THE ALLEGED
SECOND CLAIM

33. Defendants repeat and reallege each and every denial and allegation contained in paragraphs 1 through 32 hereof.

34 and 35. Deny each and every allegation contained in paragraphs 34 and 35.

FIRST AFFIRMATIVE DEFENSE

36. The complaint fails to state any claim upon which relief can be granted.

SECOND AFFIRMATIVE DEFENSE

37. Any purported claim in the complaint is moot in that the shareholders of the Fund approved The New Investment Advisory Agreement at their meeting held July 17, 1973, and further approved another Investment Advisory Agreement July 18, 1974 and plaintiff is bound thereby pursuant to shareholder contract by the action of the shareholders as a body.

THIRD AFFIRMATIVE DEFENSE

38. To the extent the complaint purports to claim equitable relief, plaintiff has unclean hands and seeks to maintain and obtain unjust enrichment in that the existing and uncontrollable expenses of the Fund properly attributable to plaintiff's own 86 shares including postage, printing, bank charges and other necessary expenses exceed both the former 1% and the present 1 1/2% expense ratio limitation as prescribed in the investment advisory agreement, and the complaint must fail for want of equity.

FOURTH AFFIRMATIVE DEFENSE

39. Any claim for money damage, if any, for 1973 is de minimis, and no claim for money damage for 1974 can be made until following December 31, 1974.

FIFTH AFFIRMATIVE DEFENSE

40. Plaintiff has failed to allege proper

grounds for failure to make demand upon the directors of the Fund, and this action may not be maintained.

SIXTH AFFIRMATIVE DEFENSE

41. Plaintiff cannot fairly and effectively represent the rights and interests of defendant American Investors Fund, Inc. or the body of its shareholders who have expressly taken action contrary to that sought by the plaintiff who seeks by this action to violate her contract with such corporation and with its body of shareholders.

SEVENTH AFFIRMATIVE DEFENSE

42. At the time of commencement of this action and to the present plaintiff had actual knowledge that there was and is no good ground for commencing or maintaining this action as required by Rule 11 of the Federal Rules of Civil Procedure.

WHEREFORE, defendants demand judgment dismissing the complaint together with the costs and disbursements of this action plus reasonable attorneys fees and appropriate relief pursuant to Rule 11 of the Federal Rules of Civil Procedure.

ROGERS HOGE & HILLS

By _____
A Member of the Firm
Attorneys for Defendants
American Investors Fund, Inc.
George A. Chestnutt, Jr.
Chestnutt Corporation
90 Park Avenue
New York, N. Y. 10016
(212) 953-9200

session proceedings. Thus even if *Weisenbloom* is construed to hold that a state cannot force the United States to litigate possession actions in the local courts, it does not reach the question of whether the Congress can bring about such a result.

The petitioners' argument that the United States should not be considered a landlord within the meaning of the ejectment statute is without merit. All the cases cited by the petitioners dealt with statutes which if held applicable to the United States would have subjected it to affirmative state regulation. In the instant case, the United States is not subjected to regulation by the ejectment statutes. Rather those statutes merely prescribe the proper court to be used in seeking judicial relief for possession.

[4, 5] The petitioners argue lastly that the purely local jurisdiction assigned to the Superior Court in the Court Reform Act cannot encompass the administration of federal public housing programs, which are national in scope. The argument is patently without merit. Any claims which the petitioners may wish to make concerning federal housing policy can be raised in the Superior Court as defenses to the instant actions brought by the United States.* Moreover, federal defenses to an action do not confer federal jurisdiction on a proceeding otherwise outside the cognizance of the federal courts. Louisville & Nashville R. R. v. Mottley, 211 U.S. 149, 29 S.Ct. 42, 53 L.Ed. 126 (1908); Gully v. First National Bank, 299 U.S. 109, 57 S.Ct. 96, 81 L.Ed. 70 (1936); Pan American Petroleum Corp. v. Superior Court, 366 U.S. 656, 81 S.Ct. 1303, 6 L.Ed.2d 584 (1961).

Therefore, it is this 30th day of August, 1973, without hearing pursuant to Local Rule 1-9(e), effective August 1, 1973.

Ordered that the motion of the petitioners for reconsideration be and the same is hereby denied.

* Of course, the Court expresses no view on the propriety or substance of such possible defenses.

Mildred GALFAND, on behalf of herself and on behalf of American Investors Fund, Inc., Plaintiff,

v.

George A. CHESTNUTT, Jr., and Chestnutt Corporation, Defendants,

American Investors Fund, Nominal Defendant.

Civ. A. No. 73-1516.

United States District Court,
E. D. Pennsylvania.
July 13, 1973.

Proceedings on stockholder's application for preliminary injunction restraining holding annual meeting of investment fund on ground investment adviser had entered into self-serving agreement with fund and proxy material did not disclose true nature of agreement. The District Court, Broderick, J., held that preliminary injunction would be denied since stockholder failed to prove likelihood of success and had adequate remedy at law.

Order accordingly.

1. Injunction ⇐147

Standards for issuance of preliminary injunction require moving party to demonstrate reasonable probability of eventual success on merits and irreparable injury pendente lite.

2. Securities Regulation ⇐216

Transactions between investment fund and controlling stockholder and corporation which is owned by such stockholder and which acts as investment adviser to fund will be upheld only if they are determined to be fair. Investment Company Act of 1940, § 36(b), 15 U.S.C.A. § 80a-35(b).

3. Securities Regulation ⇐221

Record in support of application for preliminary injunction in stockholder's derivative action seeking to enjoin annual meeting of investment fund on

grounds that investment adviser had entered into an agreement which was unfair to stockholders of investment fund and that proxy statements requesting approval of agreement concealed real nature of proposal failed to show reasonable probability that stockholder would succeed in proving that proposed agreement was unfair or that proxy material did not honestly disclose nature of proposed agreement and preliminary injunction would be denied. Investment Company Act of 1940, § 36(b), 15 U.S.C.A. § 80a–35(b).

4. Injunction ⇐136(3)

One requirement for issuance of preliminary injunction is irreparable injury pendente lite.

5. Injunction ⇐136(3)

Injury cannot be considered irreparable unless party seeking preliminary injunction demonstrates that its legal remedies are either inadequate or impracticable.

6. Securities Regulation ⇐221

Stockholder, who brought derivative action in which preliminary injunction against holding annual meeting was sought on ground that investment adviser had entered into self-serving agreement with investment fund by terms of which percentage of allowable expenses was increased ½%, had adequate remedy at law by suit for damages and was not entitled to preliminary injunction. Investment Company Act of 1940, § 36(b), 15 U.S.C.A. § 80a–35(b).

Richard A. Ash, Philadelphia, Pa., for plaintiff.

H. Laddie Montague, Jr., Philadelphia, Pa., for defendants.

MEMORANDUM

BRODERICK, District Judge.

This is a shareholder derivative action filed on July 6, 1973. A hearing was held on July 11, 1973 on plaintiff's request for a preliminary injunction restraining the defendant, American Investors Fund, Inc. (Fund) from conducting its annual meeting scheduled for July 17, 1973 in Greenwich, Connecticut and barring the use of the proxies. The defendant filed on July 11, 1973 a motion to transfer this action to the United States District Court for the Southern District of New York, pursuant to 28 U.S.C. § 1404(a).

The complaint alleges that defendants George Chestnutt and Chestnutt Corporation, the Fund's investment advisor, have entered into a self-dealing investment advisory agreement which is unfair to the shareholders and that the proxy statements requesting shareholder approval of the agreement conceal the real nature of the proposal.

The plaintiff claims that the proposed investment advisory contract results from a violation of the fiduciary duty set forth in Section 36(b) of the Investment Company Act, 15 U.S.C. § 80a–35(b). Plaintiff further alleges that as part of the plan the defendant, George A. Chestnutt, Jr., a citizen of Greenwich, Connecticut and President of the Fund and the President of Chestnutt Corporation, utilized his control of the other directors of the Fund by virtue of his 47% ownership of the stock of the Fund to induce the directors to breach their fiduciary duties by accepting the proposed new investment advisory agreement which has been proposed for ratification at the annual meeting on July 17, 1973. The plaintiff alleges that the proxy material is false and misleading in that it states:

> *as a result of cost increases over which neither the fund nor the advisor can exercise control,* the FUND and the advisor have determined that the 1% annual expense ratio limitation in the current Advisory Agreement shall be increased to 1½%. (Emphasis added)

Pursuant to the plaintiff's request for a preliminary injunction to enjoin the defendants from conducting the annual meeting scheduled for July 17, 1973, and the defendant's motion for a change of

venue, this Court scheduled a hearing for July 11, 1973. Due to the fact that the annual meeting is scheduled for July 17, 1973, this Court reserves decision on the defendant's motion for a change of venue pursuant to 28 U.S.C. § 1404(a) and herein decides the plaintiff's motion for a preliminary injunction.

Plaintiff's first contention in support of her motion for a preliminary injunction is that the proxy solicitation material being used to obtain shareholder approval for the proposed modification of the investment advisory agreement violates Rule 14a-9 of the Securities and Exchange Commission in that it falsely states that the change is proposed "as a result of cost increases over which neither the Fund nor the advisor can exercise control." The plaintiff's second ground is that the directors have breached their fiduciary duties in proposing the modification of the agreement imposed by Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35(b), as it is a self-enrichment proposal which is contrary to the best interests of the Fund.

The only evidence introduced by the plaintiff in support of the preliminary injunction motion is the deposition of the defendant, George Chestnutt, Jr., the Fund's April 30, 1973 prospectus, the Fund's proxy statement for the July 17, 1973 meeting, and the annual report of the Fund.

The Fund's proxy solicitation statement for the July 17, 1973 annual meeting provides as follows, in pertinent part:

APPROVAL OF THE TERMS OF NEW ADVISORY AGREEMENT

As a result of cost increases over which neither the Fund nor the Adviser can exercise control, the Fund and the Adviser have determined that the 1% annual expense ratio limitation in the current Investment Advisory Agreement shall be increased to 1½% of average monthly net assets in the contract. Heretofore, the Advisory Contract required the Adviser to reimburse the Fund to the extent that total annual expenses (exclusive of interest and taxes) exceeded 1% of average monthly net assets. Under the new agreement, no reimbursement from the Adviser would be required unless and until total annual expenses of the Fund (again, including interest and taxes) exceeded 1½% of average monthly net assets. The Investment Advisory fee schedule would not be changed under the new agreement; however, the higher allowable expense ratio limitation would benefit the Adviser by reducing the risk that some or all of the advisory fee would have to be reimbursed to the Fund due to an increase in rates for other expenses or changes in the average account size of American Investors Fund shareholders. No higher fees or costs would have been incurred by the Fund had the proposed new Agreement been in effect in 1972.

The contract provides that the total expenses of the Fund (exclusive of interest and taxes but including the advisory fee) shall not be more than 1½% of the average monthly net assets of the Fund. The Board of Directors of the Fund has agreed, however, that should the Fund register its shares for sale in states which impose a more stringent expense limitation, the Adviser will reimburse the Fund for expenses above the limitation imposed by such states. The Board of Directors of the Fund and the Adviser contemplate making undertakings to certain states in which Fund sales are being made, which undertakings would require the Adviser to reimburse the Fund to the extent that total expenses of the Fund (exclusive of interest and taxes) exceed 1½% of the first $30 million and 1% of the excess over $30 million. However, no assurance can be given that the annual expense ratio will in fact be at a level less than 1½% of average monthly net assets.

The proposed new Agreement appears as pages 16-20 of this Proxy

Statement. Approval of the new Investment Advisory Agreement could, to the extent deemed appropriate by defense counsel, be used as a defense in the Fogel Litigation described in this Proxy Statement at pages 9 and 10. All provisions of the proposed Investment Advisory Agreement are the same as those contained in the current Agreement with the exception of the effective date and the change in the expense ratio limitation.

To be adopted, the new Agreement must be approved by a majority of directors who are not parties to such Agreement or interested persons of any such party and must be authorized by a vote of a majority of the outstanding shares of the Fund; by definition contained in the Investment Company Act of 1940 this means a vote of (a) holders of 67% or more of the shares of the Fund present if holders of more than 50% of the outstanding shares of the Fund entitled to vote at the meeting are present in person or by proxy, or (b) holders of more than 50% of the outstanding shares of the Fund entitled to vote at the meeting, whichever is less.

The Fund's proxy solicitation statement also provides the information concerning the officers and directors of the Fund and the Chestnutt Corporation and their financial interests in both the Fund and Advisor Corporation. Mr. Chestnutt in his deposition explained the proposed change as follows:

I pointed out first of all that we were in a severe bear market, the extent of which could not be positively predicted, and it was possible that the fund would have further shrinkage in assets. I pointed out that simultaneously with this bear market in stocks we were undergoing one of the greatest inflations that this country has seen since at least going back to the end of World War I, and that costs of the fund were basically out of control. All the Bank of New York, for example, had to do was announce a price increase for a certain function and there was nothing we could do about it, and that inevitably, with the inflation rate out of control, expenses were going up and if contrarily the market kept going down it would be inevitable that somewhere down the road, if things didn't change, that it would reach the unfair proportions of perhaps bankrupting the adviser, or causing the adviser to have to completely get out of the business; that there was a very strong possibility that way down the line something like that could happen, and that I felt that the expense limitation was unfair and I also pointed out that most of the States that I knew about that had originally imposed the one percent limitation, had been convinced by various funds and managements of those funds that the limitation was grossly unfair and had relaxed their rules accordingly. And that specifically California had done so to the extent of allowing that limit—the one percent limitation to apply to only the excess over the first thirty million dollars, and that we could still get in all of the States that were important if we conformed our contract with what those States had already recognized was fair and equitable, and that we should proceed to do it. That was my presentation of the broad overall picture, and a discussion took place among all of the directors, and I do not recall any of them seriously questioning the validity of the basic fundamentals that I presented.

Information prepared by officers of the Fund and read into the record during the deposition of Mr. Chestnutt shows that while the net assets of the Fund decreased by 15% during the period from 1967 to 1972, the Fund's expenses, excluding the advisory fee, increased by 70% or from $508,340 to $865,010.

[1] The standards for the issuance of a preliminary injunction require the moving party to demonstrate a reasonable probability of eventual success on the merits and irreparable injury *pen-*

dente lite. This Court has broad discretion, since its task involves weighing the benefits and burdens that the injunction will have on each of the parties and the public. Penn Galvanizing Company v. Lukens Steel Co., 468 F.2d 1021 (3rd Cir. 1972).

The Plaintiff contends that the directors have breached their fiduciary duty to the Fund by proposing the modification of the investment advisory agreement. The plaintiff claims that the proposed Agreement is not fair and results from self-dealing, contrary to the best interests of the Fund. The plaintiff also contends that the proxy material is false and misleading in that it states that the proposed change in the advisory agreement results from cost increases over which neither the Fund nor the advisor can exercise control.

There is insufficient evidence in the record to enable the Court to find, with reasonable probability, that plaintiff will succeed in proving either contention at the trial on the merits. Section 36(b) of the Investment Company, 15 U.S.C. § 80a-35(b) provides, in pertinent part:

> (b) For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person.

Section 36(b)(1) of the Act, 15 U.S.C. § 80a-35(b), provides:

> It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty.

[2] In considering transactions where fiduciaries have conflicts of interest, such as Mr. Chestnutt and the Chestnutt Corporation in the instant case, such transactions will be upheld only if they are determined to be fair. Pepper v. Litton, 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939). The test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain; there must be a reasonable proportion between benefits and burdens, and there must be full disclosure. Pepper v. Litton, *supra*; Globe Woolen Co. v. Utica Gas & Electric Company, 224 N.Y. 483, 490, 121 N.E. 378, 380 (1918). There is not sufficient credible evidence in this record to enable this Court to find a reasonable probability that the plaintiff will succeed in proving that the proposed agreement is unfair, or that there was not a full disclosure.

This record, at this stage, contains little, if any, evidence that the proposed Agreement is "unfair." The proxy statement sets forth the benefit of the new agreement to the Advisor and the burden to the Fund. As stated by Chief Judge Lord in Allen v. Penn Central Company, 350 F.Supp. 697, 702 (E.D. Pa.1972):

> "It is easy to find small errors and trivial omissions in any proxy statement, but '[r]easonable latitude in this area is important if nit-picking is not to become the name of the game.' Kohn v. American Metal Climax, Inc., 458 F.2d 255, 267 (C.A.3, 1972)."

The real test is whether the proxy statement "when read as a whole by a reasonable shareholder, conceals the real nature of the proposal for which the

shareholder's vote is being sought." There is not sufficient credible evidence in this record to enable this Court to find a reasonable probability that the Plaintiff will succeed in proving that the proxy material conceals the nature of the proposal to the shareholders; and that it does not convey "an honest and candid picture of the proposal." Allen v. Penn Central Company, *supra*, at p. 702.

[3] The Court, therefore, concludes that the plaintiff has not established the first prerequisite for the issuance of a preliminary injunction—a reasonable probability of eventual success on the merits.

[4, 5] The second requirement for the issuance of preliminary relief is irreparable injury *pendente lite*. Plaintiff has failed to demonstrate any threat of irreparable harm if the shareholders' meeting goes forward on July 17, 1973, and the new advisory agreement, which does not become effective until September 1, 1973, is approved. Injury cannot be considered irreparable "unless plaintiff demonstrates that its *legal remedies* are *either inadequate or impracticable*." A.L.K. Corporation v. Columbia Pictures Industries, Inc., 440 F.2d 761, 763 (3d Cir. 1971). (Emphasis added.)

[6] If the plaintiff ultimately prevails at the trial on the merits in having the new agreement declared void, plaintiff has an adequate legal remedy in damages. The new agreement does not change the old agreement except in one respect: it increases the percentage of allowable expenses from 1% to 1½%. Thus, the harm to plaintiff only occurs if expenses exceed 1%, and if the new agreement is void the defendant, Chestnutt Corporation, would be liable to the Fund in damages for that excess. Accordingly, the plaintiff has an adequate remedy at law.

In balancing the benefits and burdens that granting or denying the injunction will have on each of the parties and the public, the record shows that $65,000 has already been expended in connection with the Fund's annual meeting scheduled for July 17, 1973. Should that meeting be enjoined, that money will be wasted. In contrast to the potential waste of substantial monies already expended, there is no prejudice to plaintiff and the other shareholders if the annual meeting proceeds as scheduled. To the extent action taken at the annual meeting may result in a voidable contract, damages, if any, may be recovered from the defendants.

In conclusion, the plaintiff has not demonstrated a reasonable probability of eventual success on the merits or irreparable injury *pendente lite*. The plaintiff has also failed to demonstrate that the harm suffered by the plaintiff and the shareholders if the injunction is denied outweighs the burdens that the defendants will suffer if the injunction is granted. The Court, therefore, concludes that a preliminary injunction is inappropriate.

This Memorandum and Order shall constitute the Court's findings of fact and conclusions of law, pursuant to Rule 52(a), Federal Rules of Civil Procedure.

Mildred GALFAND et al.
v.
George A. CHESTNUTT et al.
Civ. A. No. 73-1516.

United States District Court,
E. D. Pennsylvania.
Aug. 16, 1973.

Proceedings on motion to transfer stockholder's derivative action. The District Court, Broderick, J., held that since plaintiff's convenience in maintaining suit in Pennsylvania was solely the fact that her son, who was her investment adviser, resided in Pennsylvania and she was represented by a Penn-

Feb 13, 1975

Docket File

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MILDRED GALFAND, on behalf of herself and on behalf of AMERICAN INVESTORS FUND, INC., Plaintiff, -against- GEORGE A. CHESTNUTT, JR., and CHESTNUTT CORPORATION, Defendants, -and- AMERICAN INVESTORS FUND, INC., Nominal Defendant.	73 Civ. 3849 (CLB) PRE-TRIAL ORDER

Pursuant to Rule 16 of the Federal Rules of Civil Procedure, IT IS ORDERED

I Nature of Action and Parties

(a) Nature of Action

This is a derivative action on behalf of American Investors Fund, Inc. ("AIF"), a New York corporation registered pursuant to the Investment Company Act of 1940 (15 U.S.C. §§80 a-1, et seq.) ("the Act") as an open-end diversified investment company for alleged breach of fiduciary duty under the Act and principles of common law in connection with a New Advisory Agreement (New Advisory Contract)

made as of September 1, 1973. (Ex. 10).* The proxy statement issued in connection with the shareholder vote on The New Advisory Contract (Ex. 2) is also challenged as misleading.

(b) Parties

The parties are:

Plaintiff Mildred Galfand, a shareholder of AIF at all times relevant to the action.

Defendants

(i) AIF - The fund on whose behalf the action is brought - a nominal defendant.

(ii) Chestnutt Corporation - Investment adviser to AIF at all times relevant to the action.

(iii) George A. Chestnutt, Jr. - Director and President of AIF and Director, President and principal shareholder of Chestnutt Corporation.

II Jurisdiction

Jurisdiction is asserted under Section 44 of the Act, Section 27 of The Securities Exchange Act of 1934 (15 U.S.C. §78aa) ("The Exchange Act") and principles of pendent jurisdiction.

III Stipulated Facts

The following facts are stipulated to be true and require no proof for the purposes of this action only, and the parties reserve all rights to object to admissibility on the grounds of relevance, materiality and competency.

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* Reference throughout to exhibits are exhibits marked on the depositions in these proceedings.

1. The fund is an open end investment company incorporated in New York of the no-load variety as described in Sec. 10(d) of the Act as follows:

"(d) Notwithstanding subsections (a) and (b)(2) of this section, a registered investment company may have a board of directors all the members of which, except one, are interested persons of the investment adviser of such company, or are officers or employees of such company, if--

(1) such investment company is an open-end company;

(2) such investment adviser is registered under title II of this Act and is engaged principally in the business of rendering investment supervisory services as defined in title II;

(3) no sales load is charged on securities issued by such investment company;

(4) any premium over net asset value charged by such company upon the issuance of any such security, plus any discount from net asset value charged on redemption thereof, shall not in the aggregate exceed 2 per centum;

(5) no sales or promotion expenses are incurred by such registered company; but expenses incurred in complying with laws regulating the issue or sale of securities shall not be deemed sales or promotion expenses;

(6) such investment adviser is the only investment adviser to such investment company, and such investment adviser does not receive a management fee exceeding 1 per centum per annum of the value of such company's net assets averaged over the year or taken as of a definite date or dates within the year;

(7) all executive salaries and executive expenses and office rent of such investment company are paid by such investment adviser; and

(8) such investment company has only one class of securities outstanding, each unit of which has equal voting rights with every other unit."

Investment companies not meeting the above description are required by subsections (a) and (b)(2) to have a board of directors comprised of not more than 60 per centum who are "interested persons" as defined by Section 2(a)(19) of the Act, or, in the event that a principal underwriter is an "interested person", a

majority of the board of directors shall not be "interested persons" of the investment company or of the principal underwriter.

2. As a "no-load" fund, the shares of AIF are sold to the public at net asset value, without a sales charge or underwriting commission, and are redeemable without a withdrawal charge.

3. Defendant Chestnutt Corporation (the Adviser) is a Connecticut corporation whose sole place of business is 88 Field Point Road, Greenwich, Connecticut. It and its predecessors have been the investment adviser to the Fund since incorporation in 1957, and at all relevant times its board of directors has consisted of Geroge A. Chestnutt, Jr., Warren K. Greene, Clendon H. Lee and Stanley L. Sabel.

4. Chestnutt Corporation served as investment adviser to AIF pursuant to an advisory contract dated as of September 1, 1972 ("Old Advisory Contract") (Ex. 4). Chestnutt Corporation (or its predecessor) had served as investment adviser to AIF since AIF's formation in 1957 under various other advisory agreements.

5. Defendant George A. Chestnutt, Jr., is and has been President and a director of both the Fund and the Adviser since incorporation and at all relevant times has owned approximately 46% of the Adviser.

6. The Old Advisory Contract provided for a term of two years from September 1, 1972 (Ex. 4 ¶11) but could be sooner terminated, without penalty by either AIF or Chestnutt Corporation on 60 days written notice (Ex. 4 ¶14).

7. Under the terms of the Old Advisory Contract, Chestnutt Corporation agreed to provide AIF, among other things;

(i) research, statistical and advisory services and assistance and guidance in the administration of AIF's assets (Ex. 4 ¶1);

(ii) office space and in connection therewith all utilities, office supplies and stenographic clerical, mailing and messenger service (Ex. 4 ¶7); and

(iii) payment of all AIF's executive salaries and payment of all promotional, travel and entertainment expenses relating to AIF's sales. (Ex. 4 ¶7);

8. Payment to Chestnutt Corporation by AIF under paragraph 9 of the Old Advisory Contract was the amount obtained by applying the following quarterly rates to the value of AIF's net assets at the end of each calendar quarter:

Quarterly Rate	Equivalent Annual Rate	Net Assets of the Corporation
0.2 of 1%	0.8 of 1%	on the first $50 million
0.15 of 1%	0.6 of 1%	on the next $50 million
0.1 of 1%	0.4 of 1%	on the next $200 million
0.0875 of 1%	0.35 of 1%	on the next $200 million
0.075 of 1%	0.3 of 1%	on net assets in excess of $500 million

The advisory fee, however, was subject to a 1% expenses limitation ("expense limitation"). The expense limitation of the Old Advisory Agreement

read as follows ("Corporation" referring to AIF and "Investment Adviser" referring to Chestnutt Corporation):

> "provided, however, that the annual fee of the Investment Adviser shall not be more than an amount which when added to the other charges of the Corporation (exclusive of interest and taxes) shall result in total charges per annum to the Corporation inclusive of the fee of the Investment Adviser (but exclusive of interest and taxes) of 1% of the value of the Corporation's average monthly net assets for any year."

The payments under the Old Advisory Contract, subject to the expense limitations, were to be calculated as of July 1, 1972 by a specific provision of paragraph 9 of said agreement.

9. At May 21, 1973 the AIF directors were the following:

Director	First Became Director of AIF	Relationship to Chestnutt Corporation
George A. Chestnutt, Jr. ("interested person")	1957	President, Director & principal shareholder
John Currier ("interested person")	1962	Shareholder
Frank L. Fowler, Jr.	1962	None
Warren K. Greene ("interested person")	1966	Shareholder & Vice President & Director
Clendon H. Lee ("interested person")	May 21, 1973	Director and Counsel
Stanley Law Sabel ("interested person")	1957	Director, shareholder and former counsel
William A. Semmes	1969	None
Eugene A. Ulrich	1971	None

10. Ulrich, Semmes and Fowler were the only AIF directors who had never held any position or shares ownership of Chestnutt Corporation. No one of these persons served as a director of a publicly held corporation, other than AIF, prior to July 17, 1973.

11. Neither director Greene nor Currier had served as a director of a publicly held corporation, other than AIF, prior to July 17, 1973.

12. The Fund's and Adviser's sole place of business from inception until May 2, 1966 was Larchmont, New York, and on that date they moved to Greenwich, Connecticut which has been the sole place of business since that date.

13. All purchase of fund shares are made either at the Fund's office in Connecticut (formerly in New York) or at The Bank of New York, the Fund's custodian and transfer agent, in Manhattan.

14. The Fund's sales are made by mail and telephone paid for by the Adviser, and are made in interstate commerce (except New York and Connecticut sales).

15. The advisory agreements under which the Adviser has served the Fund, including the Old Advisory Contract (Ex. 4) could be terminated by either party on 60 days written notice and were for terms of two years.

16. Plaintiff Mildred Galfand purchased shares of the Fund while a resident of Pennsylvania, and at the time of the commencement of this action was a resident of New Jersey and the holder of 86 shares.

17. Plaintiff was a resident of Pennsylvania when she purchased Fund shares by mail in interstate commerce.

18. A meeting of Fund directors was held May 21, 1973 at which all directors were present, including Clendon H. Lee elected that date, and the board authorized the calling of the Annual Meeting of Shareholders to be held July 17, 1973 for the purposes, among other things, of considering and acting upon a new advisory agreement. The "expense limitation" of the existing advisory agreement was discussed.

19. Prior to June 5, 1973 at least one proof of a AIF proxy statement was distributed to AIF directors. The proof contained as an exhibit a proposed new advisory contract identical to the old in all respects except for the date and the expense limitation which was increased from 1% to 1-1/2%. (Ex. 19).

20. A meeting of Fund directors was held June 5, 1973, at which all directors were present except John Currier, and a majority of the directors, including a majority of the directors who were not interested persons, approved the submission to the shareholders of a New Advisory Agreement for ratifi-

cation or rejection to be dated as of September 1, 1973 and providing for an increase in the expense limitation from 1% to 1 1/2% (Ex. 8). There was distributed to the AIF directors at this meeting a chart prepared by director Eugene A. Ulrich which has been marked as Ex. 14A to the depositions herein. (Ex. 14B is a typed copy prepared during the litigation for the convenience of the Court and the parties).

21. On April 27, 1973 copies of the Adviser's annual financial statement for the year 1972 as required to be filed by the Fund with the Securities and Exchange Commission were mailed to Fund directors, and all directors had acknowledged receipt thereof by May 1, 1973.

22. Douglas Cram, Secretary and Counsel to AIF in June 1973, prepared a memorandum of a telephone conversation between himself and a SEC staff member respecting the AIF proxy statement covering the vote on the New Advisory Contract (Ex. 11). Cram responded to that telephone conversation by a letter dated June 21, 1973. (Ex. 12)

23. The notice of meeting of AIF shareholders to be held July 17, 1973 and a proxy statement dated June 21, 1973 were mailed to AIF shareholders on or about June 21, 1973 (Ex. 2).

24. The notice of meeting and proxy statement dated June 21, 1973 containing the proposed New Agreement in its entirety were mailed to shareholders, and on July 17, 1973 Fund shareholders by a vote of

13,120,301 shares in favor and 3,163,069 shares against approved the New Agreement which was thereafter made.

25. The effect of replacing the Old Advisory Contract by the New Advisory Contract for purposes of this litigation was that the 1 1/2% expense limitation applied to the advisory fee instead of the 1% expense limitation for the period from July 1, 1973 to June 30, 1974.

26. From the date the Fund made its first investment in January 1958 through December 31, 1974 the Dow Jones Industrial Average has increased by 38.4% while in the same period the net asset value per share of the Fund (including capital distributions but excluding income distributions) has increased 3.0 times as much, or by 116.5% per share, and the year by year comparisons are shown in the following table:

Period Ended	American Investors Fund	Dow Jones Industrials
Dec. 31, 1958....	+33.2%	+31.1%
Dec. 31, 1959....	+16.0%	+16.4%
Dec. 31, 1960....	- 3.4%	-9.3%
Dec. 31, 1961....	+32.7%	+18.7%
Dec. 31, 1962....	-14.3%	-10.8%
Dec. 31, 1963....	+37.4%	+17.0%
Dec. 31, 1964....	+14.9%	+14.6%
Dec. 31, 1965....	+49.3%	+10.9%
Dec. 31, 1966....	+ 2.9%	-18.9%
Dec. 31, 1967....	+45.5%	+15.2%
Dec. 31, 1968....	+10.1%	+ 4.3%
Dec. 31, 1969....	-29.7%	-15.2%
Dec. 31, 1970....	-29.3%	+ 4.8%
Dec. 31, 1971....	+ 3.6%	+ 6.1%
Dec. 31, 1972....	+10.4%	+14.6%
Dec. 31, 1973....	-16.2%	-16.6%
June 30, 1974....	-24.8%	- 5.7% (6 mos.)
Dec. 31, 1974....	-31.0%	-27.6% (12mos.)

27. Documents marked for identification at depositions taken to date in this action are authentic and true copies of the originals and may be introduced into evidence subject to any relevancy objections. Copies of exhibits 1, 2, 3 and 15 rather than the original exhibits may be introduced into evidence, subject to any relevancy objections. Said documents are listed on Ex. A hereto.

28. The deposition transcripts of each witness deposed herein may be introduced into evidence, without subscription, but with agreed errata changes suggested by counsel and subject to any valid objection ruled upon by the Court, all such objections having been reserved for trial. The persons deposed and the date of the depositions are set forth on Ex. B hereto.

Dated: February , 1975

SO ORDERED

Charles H. Brieant, Jr.
U.S.D.C.

The foregoing is the Pre-Trial Order pursuant to Rule 16 F.R.C.P. prepared by the parties to this action.

KREINDLER & KREINDLER

By _____ (Feb. 13, 1975)

99 Park Avenue
New York, New York 10016

ROGERS HOGE & HILLS

By _____ (Feb. 13, 1975

90 Park Avenue
New York, New York 10016
Attorneys for Defendants

EXHIBIT A

Deposition Exhibit No.	Description
1	AIF Prospectus dated April 30, 1973
2	AIF Notice and Proxy Statement for AIF Annual Meeting of Shareholders to be held July 17, 1973. [This contains New Advisory Agreement and covered the AIF shareholder vote by which the Old Advisory Agreement was replaced by the New Advisory Agreement].
3	AIF 1972 Annual Report
4	Executed Investment Advisory Agreement between AIF and defendant Chestnutt Corporation. [The Old Advisory Contract].
5	Minutes of Annual Meeting of AIF Shareholders July 18, 1972.
6	Minutes of AIF Board of Directors Meeting May 21, 1973.
7	Fundscope Magazine May 1972 - pp. 117 and 118 reflecting results of 206 funds 5 year performance results January 1, 1967 to December 31, 1971.
8	Minutes of AIF Board of Directors Meeting June 5, 1973.
9	Munutes of Annual Meeting of AIF Shareholders July 17, 1973.
10	Executed Investment Advisory Contract between AIF and defendants Chestnutt Corporation. [The New Advisory Agreement].
11	Memorandum June 15, 1973 from Douglas Cram to File re SEC Comments on 1973 Proxy Statement.
12	Letter dated June 21, 1973 AIF by Cram to SEC.
13	AIF 1973 Annual Report.
14A	Handwritten notes with data on 21 funds. [Statement at bottom beginning "Prepared by Eugene Ulrich..." placed on exhibit for purposes of this litigation].
14B	A typed version of 14A and prepared for this litigation.
14C	Director Semmes copy of Ex. 14A. [Ink changes at top done by Semmes].

	15	Statement of AIF Average Monthly Net Assets for 1973 and AIF expenses for 1972 and 1973. [Prepared in response to plaintiffs' interrogatories herein].
	16	Chestnutt Corporation consolidated financial statement for December 31, 1972.
	17	Chestnutt Corporation consolidated financial statement for December 31, 1971.
	18	Chestnutt Corporation consolidated financial statement for December 31, 1970.
	19	Proof of June 1, 1973 AIF Notice and Proxy Statement for July 17, 1973 shareholders' meeting.
	20	Letter dated June 5, 1973 SEC to Cram at AIF.
	21	June 1, 1973 Proof of Proxy Statement with Notes of Cram.
	22	AIF Quarterly Report for March 31, 1974.
	23	Letter dated April 9, 1974 from Currier to Lee with handwritten exhibit ated March 20, 1973.
	24	AIF Semi-Annual Report June 30, 1974.
dant's it	A	Investment Company Institute Analyses and Mutual Fund Expense Ratios (Dated March 17, 1973).

EXHIBIT B

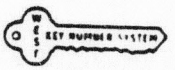
Date	Deponent
6/4/74	George A. Chestnutt, Jr. (Def.)
7/11/73	George A. Chestnutt, Jr. (Def.)
3/22/74	John Currier - Director of AIF
3/22/74	Warren K. Greene - Director of AIF
3/22/74	Eugene Arthur Ulrich - Director of AIF
3/29/74	Frank G. Fowler - Director of AIF
6/4/74	William A. Semmes - Director of AIF
1/15/75	Clendon H. Lee - Director of AIF

both arise out of the same basic transactions and occurrences, involve essentially the same operative facts, and should—it is agreed—eventually be consolidated.[1]

Each defendant (i. e., Mountain States in Case No. C-1-74-516, and C. C. Pack in Case No. C-1-75-71) originally filed a separate motion to dismiss or, in the alternative, to transfer (docs. 8 and 5, respectively). But subsequent submissions by defendants in support of the transfer issue were filed jointly—that is, a single reply memorandum and a single supporting affidavit were submitted on behalf of both defendants. This was accomplished by the simple expedient of a dual caption; and it was feasible since the issues were essentially the same in each case, the cases were appropriate for consolidation, and both defendants were represented by the same counsel. Plaintiff Artisan Development responded to the two separate transfer motions by submitting a single, dual-captioned, memorandum contra (doc. 10). It is thus apparent that our Opinion and Order of May 30, 1975, should also have been addressed to Case No. C-1-75-71 and the transfer motion of defendant Pack.

Accordingly, for reasons set out in our aforementioned opinion and because the cases are appropriate for consolidation, we conclude that Case No. C-1-75-71 should also be transferred to the Eastern District of Tennessee, Northern Division, at Knoxville, Tennessee, and it is so ordered.

One further point regarding the above-mentioned cases should perhaps be clarified at this time. As noted earlier, motions to dismiss (for lack of jurisdiction and improper venue) were pending in both cases along with the alternative motions for transfer. Although the motions to dismiss were not orally argued, there were memos pro and con. On the basis of the authorities cited in the plaintiff's memos, we think it clear that the motions to dismiss were not well taken. Thus, since we overlooked noting this in the earlier opinion, we hereby deny the motions to dismiss.



Mildred GALFAND, on behalf of herself and on behalf of American Investors Fund, Inc., Plaintiff,

v.

George A. CHESTNUTT, Jr., and Chestnutt Corporation, Defendants,

and

American Investors Fund, Inc., Nominal Defendant.

No. 73 Civ. 3849.

United States District Court, S. D. New York.

July 23, 1975.

Supplemental Findings and Conclusions Nov. 10, 1975.

Stockholder brought action against director of mutual fund and the fund's investment advisor for judgment voiding new investment advisory agreement increasing expense ratio limitation from 1% to 1½%. Defendants' motion for change of venue was granted, 363 F. Supp. 296. The District Court, Brieant, J., held that desire to improve advisor's profits was, perhaps not improper motivation of interested directors of mutual fund, but to do so without full disclosure and discussion of advisor's financial condition and the likelihood of a refund to fund coming due under balance of agreed term of then-existing investment advisory agreement was inappropriate

1. Of course, the respective parties do not agree as to where the cases should be consolidated.

and that evidence established that statements, in proxy materials seeking shareholder approval of proposed new advisory agreement, that increase in expense ratio limitation was proposed "as a result of cost increases over which neither the Fund nor the Adviser can exercise control," and that "No higher fees or costs would have been incurred by the Fund had the proposed new Agreement been in effect in 1972" were false and misleading.

Judgment accordingly.

1. Securities Regulation ⇐215

A finding of failure to comply with statutory requirement that investment advisor furnish and directors of investment company consider relevant information regarding fees and payments to advisor does not, standing alone, establish a per se violation of the Investment Company Act and would not therefore render investment advisory contract voidable at instance of shareholder on behalf of the investment company. Investment Company Act of 1940, §§ 15(c), 36(b), 47(b), 15 U.S.C.A. §§ 80a-15(c), 80a-35(b), 80a-46(b).

2. Securities Regulation ⇐223

Purpose of statute authorizing action against investment advisor for breach of fiduciary duty in respect to compensation was to make it clear that fund managers have a fiduciary duty to the funds they advise, to give shareholders a right to sue for breach of that duty, and to overrule decided cases which had held that if advisory contracts were ratified by shareholders, or in some states, approved by a vote of disinterested directors, shareholders must show mismanagement and waste of corporate assets before excessive management fees could be recovered. Investment Company Act of 1940, § 36(b), 15 U.S.C.A. § 80a-35(b).

3. Securities Regulation ⇐223

A violation of statutory requirement that investment advisor furnish and directors of investment company consider relevant information regarding fees and payments to advisor does not relieve courts of responsibility to evaluate all evidence before determining that there has been a breach of fiduciary duty. Investment Company Act of 1940, § 15(c), 15 U.S.C.A. § 80a-15(c).

4. Banks and Banking ⇐314

Directors of mutual fund held a position of trust and confidence with respect to the fund's shareholders, and owed them the obligations commonly associated with fiduciaries. Investment Company Act of 1940, § 36(b), 15 U.S.C.A. § 80a-35(b).

5. Securities Regulation ⇐215

Issue of modification of investment advisory agreement to increase expense ratio limitation presented a clear conflict of interest between mutual fund and its investment advisor, and such a transaction could be upheld only if, after subjecting it to rigid judicial scrutiny, it was found to be fair. Investment Company Act of 1940, § 36(b), 15 U.S.C.A. § 80a-35(b).

6. Securities Regulation ⇐215

Seeing its profits dwindling as mutual fund's assets declined, it was not surprising that investment advisor would want to eliminate future possibility of a rebate to fund by increasing expense ratio limitation provided for in investment advisory agreement, but equity imposed a higher standard. Investment Company Act of 1940, § 36(b), 15 U.S.C.A. § 80a-35(b).

7. Securities Regulation ⇐215

Desire to improve investment advisor's profits was, perhaps, not improper motivation of interested directors of mutual fund, but to do so without full disclosure and discussion of advisor's financial condition and the likelihood of a refund to fund coming due under balance of agreed term of then-existing investment advisory agreement was inappropriate; without this, it could not be said that, under all the circumstances, the contract was the result of arm's length negotiations. Investment Compa-

ny Act of 1940, §§ 10(d), 15, 36(b), 47(b), 15 U.S.C.A. §§ 80a-10(d), 80a-15, 80a-35(b), 80a-46(b).

8. Securities Regulation ⇐215

Statutory requirements that investment advisory contract contain a 60-day mutual cancellation clause and that a contract which has been in effect for a period of more than two years be approved at least annually by board of directors or by a vote of majority of shareholders were intended to protect the parties from such eventualities as irreconcilable good-faith disputes, good-faith dissatisfaction with performance, dissolution of the fund, or withdrawal by the advisor from business, and were not intended to be used as a means by which to repudiate a valid unexpired agreement solely in self-interest of the advisor. Investment Company Act of 1940, § 15(a)(2, 3), 15 U.S.C.A. § 80a-15(a)(2, 3).

9. Contracts ⇐168

In every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.

10. Securities Regulation ⇐215

Although state law permitted parties to modify investment advisory contract without consideration if modification was in writing, in view of fiduciary relationship between mutual fund and its investment advisor, they could not do so except on reasonable grounds believed in good faith to be mutually beneficial. Investment Company Act of 1940, §§ 36(b), 47(b), 15 U.S.C.A. §§ 80a-35(b), 80a-46(b); General Obligations Law N.Y. § 5-1103.

11. Securities Regulation ⇐50

Responsibility for adequacy of proxy materials is imposed upon those soliciting the shareholders' votes, and not upon government employees who perform what is basically a police function. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

12. Securities Regulation ⇐49

Director of mutual fund, in preparing proxy statement in connection with proposed new investment advisory agreement, had duty to stand up to member of staff of SEC if his suggestions were without merit.

13. Securities Regulation ⇐[illegible]4

Evidence established that statements, in proxy materials seeking shareholder approval of proposed new investment advisory agreement, that increase in expense ratio limitation was proposed "as a result of cost increases over which neither the Fund nor the Adviser can exercise control," and that "No higher fees or costs would have been incurred by the Fund had the proposed new Agreement been in effect in 1972" were false and misleading. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

14. Securities Regulation ⇐51

President and director of mutual fund, who was also owner of 47% of shares of fund's investment advisory, breached Securities Exchange Act and rule promulgated thereunder by omitting to disclose in proxy solicitation that change in investment advisory contract to increase expense ratio limitation might result in a loss of a foreseeable rebate to the fund. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

15. Federal Civil Procedure ⇐187

To protect important public policies requiring that management of a corporation be entrusted in first instance to the discretion of its directors, and prevent initiation and maintenance of strike suits brought solely to humiliate defendants and extract legal fees, timely demands on directors followed by refusal are ordinarily a condition precedent to derivative litigation. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a); Investment Company Act of 1940, § 20(a), 15 U.S.C.A. § 80a-20(a);

Fed.Rules Civ.Proc. rule 23.1, 28 U.S.C.A.; Business Corporation Law N.Y. § 626(c).

16. Federal Civil Procedure ⇐187

Fact that director of mutual fund and its investment advisor had resisted tenaciously and effectively stockholder's attempt to enjoin stockholders' meeting on proposed new investment advisory agreement increasing expense ratio limitation, their defense of the litigation, and fact that their own proxy statement and their own acts were brought directly in question by stockholder's claims warranted finding that any preliminary demand on the fund or its directors would have been futile and thus should be excused as unnecessary. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a); Investment Company Act of 1940, § 20(a), 15 U.S.C.A. § 80a-20(a); Fed.Rules Civ.Proc. rule 23.1, 28 U.S.C.A.; Business Corporation Law N.Y. § 626(c).

17. Contracts ⇐215(1)

Where original investment advisory contract was dated "as of September 1, 1972," and provided "This agreement shall remain in effect for a period of two years from date hereof. . . . ," expiration date of contract was August 31, 1974, and not June 30, 1974, for purposes of application of 1% expense ratio limitation therein in case in which it was determined that new contract, which increased such limitation, was void and unenforceable.

18. Contracts ⇐215(1)

Investment advisory agreement which was drafted by competent attorneys and which was not ambiguous would be construed as it was written in determining expiration date.

19. Securities Regulation ⇐220

Federal court would not assume parties included gratuitous language in so vital a section of investment advisory agreement as advisory fee paragraph.

20. Banks and Banking ⇐315(1)

Under advisory fee paragraph of agreement between mutual fund and its investment advisor, first payment to advisor was not to be computed on basis of average net asset value of the fund for the month of September only, but on basis of a figure representing an average of the net asset values for each of the three months in the quarter, July 1 through September 30.

21. Banks and Banking ⇐315(1)

Equity required that counsel fees paid or accrued by mutual fund as expenses for outside attorneys solely for purpose of stockholder's derivative action brought to void new investment advisory agreement increasing expense ratio limitation to 1½% should not be considered as expenses in applying 1% limitation in original agreement.

Kreindler & Kreindler, New York City, for plaintiff.

Rogers Hoge & Hills, New York City, for defendants.

FINDINGS AND CONCLUSIONS

BRIEANT, District Judge.

This shareholder's derivative action was commenced on July 6, 1973 in the United States District Court for the Eastern District of Pennsylvania, seeking a preliminary injunction to restrain American Investors Fund from conducting its annual shareholders meeting set for July 17, 1973.

Plaintiff owns 86 whole shares of American Investors Fund, a New York corporation ("AIF" or the "Fund"), an open-end no-load mutual fund registered under the Investment Company Act of 1940 (15 U.S.C. § 80a-1, *et seq.*, the "Act").

In addition to the Fund itself, defendants are Chestnutt Corporation, a Connecticut corporation, which is AIF's investment adviser, and George A. Chestnutt, Jr., President and Director of the Fund and President, Director and owner of 47% of the shares of the adviser.

This Court has subject matter jurisdiction pursuant to 15 U.S.C. § 80a-35(b).

On July 11, 1973, the Honorable Raymond J. Broderick, United States District Judge, Eastern District of Pennsylvania, held a hearing on plaintiff's motion for an injunction. On the same day, defendants moved to transfer the action to this Court, pursuant to 28 U.S.C. § 1404(b). On July 13, 1973, Judge Broderick denied plaintiff's motion for a preliminary injunction. [Decision reported at 363 F.Supp. 291 (E.D.Pa. 1973)]. The evidence presented in support of plaintiff's motion was limited (see 363 F.Supp. p. 293); on the basis of the sparse record before him Judge Broderick held (363 F.Supp. p. 296):

> "The Court, therefore, concludes that the plaintiff has not established the first prerequisite for the issuance of a preliminary injunction—a reasonable probability of eventual success on the merits."

Subsequently, Judge Broderick granted defendants' motion for change of venue to this Court. [Decision reported at 363 F.Supp. 296.]

On June 21, 1973, proxy solicitation materials for the annual shareholders' meeting on July 17, 1973 were mailed by management to AIF's shareholders. Proxies were solicited and shareholder approval sought, *inter alia*, for a new contract between the Fund and its investment adviser, Chestnutt Corporation. The new contract was intended to replace a prior contract dated as of September 1, 1972 (Ex. 4, hereinafter referred to as the "old agreement") which had not yet expired. The Fund and its adviser had an established custom and practice of executing two year agreements which were replaced annually, a year prior to the expiration date.

The adviser's fees were unchanged by the new agreement. The only change proposed was an increase in the "expense ratio limitation" from 1% to 1½%. Under paragraph 9 of the old agreement, the adviser was required to reimburse the Fund, up to the amount of its fee for the year, to the extent certain expenses, together with the fee, exceeded 1% of the Fund's average monthly net assets (see paragraph 9, quoted in full, *infra*, p. 1331).

Plaintiff claims Mr. Chestnutt influenced the other Fund directors improperly to have the expense ratio increased to 1½%, and did so solely for the benefit of the adviser and contrary to the interests of the Fund, to forestall an anticipated rebate of the fee during the year 1973, all in violation of 15 U.S.C. § 80a-35(b).[1]

Plaintiff also claims defendants made false and misleading statements in the proxy materials to obtain shareholder approval of the change, in violation of 15 U.S.C. § 80a-20(a)[2] and Rule 14a-9[3] [17 C.F.R. § 240.14a-9].

1. That statute reads in pertinent part as follows:

> "(b) For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by . . . a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments . . . ."

2. 15 U.S.C. § 80a-20(a) reads as follows:

> "It shall be unlawful for any person, by use of the mails or any means or instrumentality of interstate commerce or otherwise, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security of which a registered investment company is the issuer in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

3. Rule 14a-9 reads as follows:

> "(a) No solicitation subject to this regulation shall be made by means of any proxy

The proxy materials (Ex. 1) state that the expense ratio limitation increase was sought because of rising costs, which neither the Fund nor its adviser could control. Plaintiff claims this is false. The proxy materials also state that no rebate would have been due the Fund had the 1½% expense ration limitation been in effect in 1972. Plaintiff claims this statement is incomplete and misleading. With the market value of net assets declining and an expense ratio limitation of 1% of the Fund's net asset value, the Fund most likely would have been entitled to a refund of a portion of the adviser's fees for 1973. Plaintiff contends the shareholders should have been told a change to a 1½% limitation would result in a loss of that foreseeable refund.

The AIF annual meeting was held as scheduled on July 17, 1973 and the proposed new contract (Ex. 1) was approved by the Fund's shareholders.

On July 25, 1974, this Court granted defendants' motion to dismiss, as moot, the original complaint seeking equitable relief. Leave to file an amended complaint was granted plaintiff upon posting a $1,000.00 bond, pursuant to Local Rule 2 of the Civil Rules of this Court. Bond was posted, and an amended complaint was filed on August 14, 1974. The amended complaint makes the same allegations and seeks judgment voiding the new advisory agreement, requiring defendants to account for and pay over to AIF any rebate which would have been due had the expense ratio limitation of 1% remained in effect for 1973.

Trial of this action commenced on February 18, 1975 before the Court without a jury.

Factual Background of the Dispute.

AIF was formed by George Chestnutt in 1957. Since its inception, Chestnutt Corporation or its predecessors (all controlled by Mr. Chestnutt) served as adviser to the Fund, providing research and guidance in the administration of the Fund's assets, office space, and related office expenses, executive salaries and promotional costs.[4]

Mr. Chestnutt was one of the first investment advisers to develop a theory of investment strategy based on keeping complex statistical records or charts showing historical price and volume fluctuations, and relative performance of individual stocks and stocks of selected industry groups. Since 1946, Mr. Chestnutt has edited and published a weekly technical stock market letter, "American Investors Service."

Mr. Chestnutt and many respected investors believe that market trends can be predicted by analysis of statistics and charts showing trends with respect to price fluctuations of individual stocks, stocks in industry groups, and the stock market in general. Chestnutt Corporation furnishes the Fund with "continuing analysis of the action of over 1,000 issues by means of daily charts supple-

statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

[4] The Investment Advisory Agreement lists the items of expense as follows (Ex. 2, p. 17): "7. The Investment Adviser shall furnish to [the Fund] such office space as may be necessary for the suitable conduct of the [Fund's] business and all necessary light, heat, telephone service, office equipment and stationery and stenographic, clerical, mailing and messenger service in connection with such office; and pay the salaries of all of the Fund's executives, and pay all promotional, travel, and entertaining expenses relating to Fund sales."
According to AIF's prospectus (Ex. 1, p. 3): "The Fund . . . pays brokerage, transfer agent fees, costs relating to reports to shareholders, auditing and legal fees, custodian fees, registration and filing fees, and taxes, and membership fees of the Investment Company Institute."

mented by a weekly computer analysis of relative market performance," and correlations of "economic findings with technical studies in the fields of money, credit availability and banking statistics." (Ex. 1, p. 4).

The Fund was organized on the theory that, unlike other funds, it would provide an opportunity to participate in a portfolio administered in accordance with the general theories expounded by the Chartists, and Mr. Chestnutt's theories in particular. This method or practice required extensive administrative overhead. At one time, Chestnutt Corporation employed 110 people to administer this Fund and its other accounts. By the end of 1974, the staff had been cut to approximately 37. (Tr. p. 69).

The preparation of charts and computer analyses makes the service provided by Chestnutt Corporation expensive, but the Fund's shares were sold and bought upon the representation that this unique investment strategy would be pursued by the Fund's manager. Although Chestnutt's methods may not have been particularly successful in recent years, they remain respectable, and enjoy acceptance among knowledgeable investors.

As an open-end no-load investment company, the Fund may have a board of directors "all the members of which, except one, are interested persons of the investment adviser" [15 U.S.C. § 80a-10(d)]. At the time of the events in suit, AIF's board consisted of eight members, three of whom were not "interested persons". The other five, including Mr. Chestnutt, were all affiliated in some fashion with Chestnut Corporation.

Each contract between the Fund and the adviser was for a term of two years, but was submitted to the shareholders for approval annually as is required by the Act, and its terms were in compliance with the Act (15 U.S.C. § 80a-15). The annual fee received by Chestnutt Corporation was computed as a percentage of the net assets of the Fund.

The 1% expense ratio limitation was added to the contract renewed some years prior to the events in suit at the instance of state regulatory commissions, notably in California, where the Fund sold shares.

The investment performance of the Fund over the years had been relatively unsuccessful compared with other funds.[5] Fund assets had declined in market value from $220,000,000.00 in September 1972 to less than $150,000,000.00 in May 1973. Expenses had been increasing due primarily to inflation. In 1970 the Fund instituted a minimum investment requirement of $400.00. Prior thereto, it had required no minimum investment. As a consequence, it had a large proportion of small accounts, and thus its administrative expenses of the sort which are directly related to the number of accounts (shareholders) were high, compared with funds which had few small shareholders.

Violation of Fiduciary Duty.

In 1972 and early 1973, AIF, like other funds, was suffering from a decline in the total market value of its assets, caused by shareholder redemptions and a general drop in market prices of securities. In May 1973, it appeared likely that unfavorable market conditions would continue, and the adviser's total fee would therefore decline with the asset value of the Fund. It also appeared likely that expenses of the Fund would increase with the foreseeable result that Chestnutt Corporation would then be required to refund some part of its fee to the Fund in compliance with the 1% expense ratio limitation contained in the advisory contract dated September 1, 1972 then in effect. Mr. Chestnutt thought this eventuality likely within a

5. See Ex. 7, showing that for the five-year period January 1, 1967 to December 31, 1971, the Fund was last in "performance" of a group of 200 funds studied by "Fundscope," a respected financial publication.

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year or two (Deposition of George Chestnutt, June 4, 1974, p. 14).

The Board of Directors of AIF had frequently considered its rising expenses but had never considered increasing the expense ratio limitation until the matter was brought up by Mr. Chestnutt at a board meeting on May 21, 1973. Messrs. Cram and Lee, attorneys for the Fund and for Chestnutt Corporation were asked to make inquiries of those securities commissioners of the states requiring an expense ratio limitation, and to report to the board at its next meeting.

At the next meeting of the board on June 5, 1973, the proposed increase was approved, to be implemented in a new contract to be submitted at the July meeting, and dated as of September 1, 1973. Eugene Ulrich, a disinterested director of the Fund distributed to the directors on June 5th a table (Ex. 14) listing twenty funds having assets over $100,000,000.00, their number of shareholders, turnover rate, percent of expenses, and management fees. This tabulation submitted by Ulrich was the only information the directors had before them when they were discussing the advisability of increasing the expense ratio. No further information was requested by the directors and none was offered by Chestnutt Corporation.

Mr. Ulrich's initiative in furnishing this information is insufficient to fulfill the requirements of 15 U.S.C. § 80a-15(c):

". . . It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser to such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company."

[1] Plaintiff contends that a finding of failure to comply with this section, standing alone, establishes a *per se* violation of the Act, and therefore the advisory contract is voidable at her instance on behalf of the Fund, pursuant to 15 U.S.C. § 80a-46(b):

"Every contract made in violation of any provision of this subchapter . . . shall be void (1) as regards the rights of any person who, in violation of any such provision . . . shall have made or engaged in the performance of any such contract . . ."

[2] The legislative history of the 1970 amendments to the Act does not support such a conclusion. One of the most important additions to the Act made in 1970 was the section under which plaintiff sues, 15 U.S.C. § 80a-35(b). The purpose of that section was to make it clear that fund managers have a fiduciary duty to the funds they advise; to give shareholders a right to sue for breach of that duty; and to overrule decided cases which had held that if advisory contracts were ratified by the shareholders, or in some states, approved by a vote of disinterested directors, shareholders must show mismanagement and waste of corporate assets before excessive management fees could be recovered. [See *e. g., Saxe v. Brady*, 40 Del.Ch. 474, 184 A.2d 602 (1962); *Meiselman v. Eberstadt*, 39 Del.Ch. 563, 170 A.2d 720 (1961)]. Such a rule was considered unduly restrictive in the mutual fund industry where the fund and its adviser are closely related and arm's length bargaining is normally absent.

"Thus, upon a challenge in court to compensation or payments, the ultimate test, even if the compensation or payments are approved by the directors and stockholders, will not be whether it involves a 'waste' of corporate assets but will be whether the investment adviser has fulfilled his fiduciary duty to the mutual fund shareholders in determining the fee." 3 U.S.Code Cong. & Admin.News 1970, p. 4910, Senate Report No. 91-184.

Among the factors the Court "may wish to consider" in determining wheth-

er the adviser has fulfilled his fiduciary duty to the fund is "whether the deliberations of the directors were a matter of substance or a mere formality," and it was in an attempt "to assist the directors in discharging their duties" that Congress added to 15 U.S.C. § 80a–15(c) the requirement that the adviser furnish, and the directors consider, relevant information regarding fees and payments to the adviser (3 U.S.Code Cong. & Admin.News 1970, p. 4910).

[3] There is no indication whatever in the statute or the legislative history that a violation of § 80a–15(c) was intended to relieve the courts of responsibility to evaluate all the evidence before determining whether there has been a breach of fiduciary duty. Were it otherwise, there would be no need for the statement (3 U.S.Code Cong. & Admin. News 1970, p. 4910):

> "The section makes it explicit that the . . . plaintiff has the burden of proving to the satisfaction of the court that the defendant has committed a breach of fiduciary duty."

Such an interpretation of § 80a–15(c) would also make the following sections of § 80a–35(b) meaningless surplusage if all that must be shown is a failure to supply and consider information relevant to the fee, or other advantages to the adviser:

> "(1) It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty. (2) In any such action approval by the board of directors of such investment company of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, and ratification or approval of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances."

Clearly, a court is not "authorized . . . to substitute its business judgment for that of the mutual fund's board of directors in the area of management fees" but is "authorized . . . to determine whether the investment adviser has committed a breach of fiduciary duty in determining or receiving the fee." 3 U.S.Code Cong. & Admin.News, 1970, p. 4902. In doing so, the Court must exercise its traditional function of considering all the evidence in finding whether or not there has been a breach of fiduciary duty.

None of the Fund's directors, interested or otherwise, objected to the increased expense ratio on the ground that the Fund might be losing the advantage of a possible rebate during the unexpired term of the contract then in effect. Nor was it pointed out by Mr Chestnutt that a rebate would probably be due for 1973. Apparently all that was considered was the disadvantage of the existing limitation to the adviser. The disinterested directors gave only the most cursory attention to the expense ratio increase, never considered opposing Mr. Chestnutt's suggestion or asking for further information regarding Chestnutt Corporation's finances. Mr. Frank G. Fowler, who had no connection with Chestnutt Corporation, became a director of AIF in 1962. He testified (Deposition of March 29, 1974, pps. 19–20):

> "Q At the time the voting for the new advisory agreement took place, did you believe that you were giving up some advantage that the fund had?
>
> A No.
>
> Q Did you believe you were obtaining some advantage for the fund before voting for the new agreement?
>
> A I'm sure I must have felt that.
>
> Q What did you understand the advantage of the fund to be of having a

one and a half percent expense limitation instead of a one percent expense limitation?

A Well, the advisor cannot operate at a loss, and judiciously, it appeared that he needed more compensation to actively perform his duties as an advisor to the fund.

Q Was it your understanding that prior to June '73 that the advisor was operating at a loss?

* * * * * *

A I believe he was approaching it.

Q Did Mr. Chestnutt present any financial or income statements of Chestnutt Corporation, or did he just make a representation?

A I believe that he did, but that I can't recall for sure.

* * * * * *

Q At any time during your time as a director of the fund, was there ever a discussion about obtaining a new advisor for the fund?

A I don't recall any."

Mr. Ulrich testified that the particular type of investment advice supplied by Chestnutt Corporation was "very unique" and unavailable from any other adviser. Therefore he never considered changing advisers because "if I were to . . . change the type of advice . . . I would be going counter to the desires of the stockholders when they made the initial decision to buy the stock." (Tr. p. 87). See discussion, *supra*, p. 1323, concerning the special nature of Chestnutt's advice. This opinion was shared by the other disinterested directors. The importance the non-affiliated directors placed on retaining Chestnutt Corporation as investment adviser apparently made them susceptible to Mr. Chestnutt's suggestion at the May 21, 1973 board meeting that if the expense ratio were not increased (Deposition of George Chestnutt, July 11, 1973, p. 32):

"inevitably, with the inflation rate out of control, expenses were going up and if contrarily the market kept going down it would be inevitable that somewhere down the road, if things didn't change, that it would reach the unfair proportions of perhaps bankrupting the adviser, or causing the adviser to have to completely get out of the business; that there was a very strong possibility that way down the line something like that could happen, and that I felt that the expense limitation was unfair. . . ."

However, none of the directors made any attempt to determine whether Chestnutt Corporation was in financial difficulty, or intended, absent the modification, to withdraw as adviser. The consolidated balance sheet of Chestnutt Corporation as of December 31, 1972 had been mailed to AIF directors on April 27, 1973. That company's total current assets on December 31, 1972 were $759,564.00. (Ex. 2, p. 11).

Mr. Chestnutt did not submit any more recent financial data to the Fund's board. A draft of the proxy materials was received by the directors before the next meeting on June 5, 1973. This also contained the 1972 balance sheet of Chestnutt Corporation.

Chestnutt Corporation had substantial assets, and Mr. Chestnutt himself did not consider his company to be in any imminent danger of bankruptcy: "it was only the possibility of future trouble that was worrying me. . . . It was the fact that this is the sort of thing that if you don't plan ahead, you are dead and I didn't want to be dead." (Deposition of George Chestnutt, June 4, 1974, p. 17).

In fact, Chestnutt Corporation's income had been decreasing but was still substantial. Fees from AIF for the first quarter of 1972 were $303,680.47; for the first quarter of 1973 they were $284,457.94. Mr. Chestnutt's salary from Chestnutt Corporation at its highest point in 1968 or 1969 was approximately $130,000.00 per year, but dropped to approximately $79,000.00 in 1972 and 1973. (Tr. p. 61).

While the financial stability of its adviser is a matter of legitimate concern

to the Fund, there is no evidence any of the directors questioned Mr. Chestnutt's statements or attempted to verify their significance. Their only concern appears to have been that expenses were rising and thereupon they made the decision, in effect, that the Fund, rather than the adviser should bear the burden of the increase.

[4] The directors of the Fund held a position of trust and confidence with respect to the Fund's shareholders, and owed them the obligations commonly associated with fiduciaries. § 80a-35(b) explicitly imposed upon Chestnutt Corporation the standard traditionally applied to persons in a fiduciary position, and directors of AIF knew or should have known that this is the standard by which their official acts would be measured.

The increase effective September 1, 1973 from 1% to 1½% in the expense ratio limitation was obviously beneficial to Chestnutt Corporation. Nothing in the record indicates any benefit flowing to the Fund from such increase. Mr. Chestnutt's claim that unless the increase were approved, Chestnutt Corporation's continued existence and capacity to function as adviser to the Fund would be threatened, is unsupported.

[5] The issue of contract modification presented a clear conflict of interest between the Fund and Chestnutt Corporation. Such transactions will be upheld only if, after subjecting them to rigid judicial scrutiny, they are found to be fair. *Pepper v. Litton*, 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939); *United Hotels v. Mealey*, 147 F.2d 816 (2d Cir. 1945); *Securities Comm. v. Chenery Corp.*, 318 U.S. 80, 85, 63 S.Ct. 454, 87 L.Ed. 626 (1942).

[6] Seeing its profits dwindling as the Fund's assets declined, it is not surprising that Chestnutt Corporation should want to eliminate the future possibility of a rebate to the Fund, but equity imposes a higher standard. *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928); *Rosenfeld v. Black*, 445 F.2d 1337, 1343-44 (2d Cir. 1971).

[7] In *Rosenfeld, supra*, the Court held the investment adviser to a mutual fund breached its fiduciary duty by realizing a profit in connection with the appointment of a new adviser, and that the applicable standard of fiduciary duty was a matter of federal law incorporating wherever appropriate equitable safeguards long known to the common law, as had been held in *Brown v. Bullock*, 294 F.2d 415 (2d Cir. 1961). The Court noted that (*Rosenfeld, supra*, at 1345):

> "When Congress, in § 15(a), required shareholder approval of any new advisory contract, it must have meant an approval uninfluenced by any improper motivations on the part of the outgoing adviser-fiduciary."

The same may be said in this case. The desire to improve Chestnutt Corporation's profits was, perhaps, not "improper motivation" of the interested directors here, but to do so without full disclosure and discussion of Chestnutt's financial condition and the likelihood of a refund to AIF coming due under the balance of the agreed term of the then existing contract, was inappropriate. Without this, it cannot be said that, under all the circumstances, the contract was the result of arm's length negotiations. *Pepper v. Litton, supra.*

[8, 9] AIF's board was presented with the suggestion that its adviser faced insolvency, which is patently untrue on the record before this Court, and the right of the Fund to have the 1½ limitation apply in the second year of the old agreement was surrendered. It is no answer to say there was a 60-day mutual cancellation clause and the contract was submitted to the shareholders each year. These are requirements of the Act [15 U.S.C. § 80a-15(a)(2) and (3)] and were intended to protect the parties from such eventualities as irreconcilable good faith disputes, good faith dissatisfaction with performance, dissolution of the Fund, or withdrawal by the

adviser from business. It was not intended to be used as a means by which to repudiate a valid unexpired agreement solely in the self-interest of the adviser, since:

> "'in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing,' *Kirke La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933)." *VTR, Inc. v. Goodyear Tire & Rubber Co.*, 303 F.Supp. 773, 777 (S.D.N.Y.1969).

See also 3 Corbin, Contracts, § 568, pp. 331–334 (1960).

[10] New York law permits parties to modify a contract without consideration, if the modification is in writing (Gen.Obl.Law. § 5–1103, McKinney's Consol.Laws, c. 24–A), but the parties here, because of the fiduciary relationship, could not do so except on reasonable grounds believed in good faith to be mutually beneficial. Under these circumstances it borders on fraud to suggest that the adviser was faced with insolvency during the period for which it had agreed to the 1% limitation. A different situation may exist with respect to the subsequent year.

The new contract ratified by AIF shareholders on July 18, 1973 must be considered a modification of the earlier contract as to the year September 1, 1973 to August 31, 1974 inclusive.

In accordance with 15 U.S.C. § 80a–46, I find that the modification is void and unenforceable against the Fund. Plaintiff is entitled for this reason alone, to recover damages on behalf of AIF in the amount by which expenses exceeded the 1% expense ratio limitation set forth in the original contract during its original term.[6]

Proxy Rule Violation.

We now turn to the proxy materials mailed on June 21, 1973. The statements in the proxy materials claimed to be false or misleading are: (1) that the increase in the expense ratio limitation was proposed "as a result of cost increases over which neither the Fund nor the Adviser can exercise control," and (2) that "No higher fees or costs would have been incurred by the Fund had the proposed new Agreement been in effect in 1972." (Ex. 2, p. 6).

[11, 12] We observe preliminarily that the second statement quoted above and claimed to be misleading was added to the draft of the proxy solicitation materials at the instance of a member of the staff of the SEC in Washington, D. C., assigned to examine the proxy statement. (Ex. 11). Under the circumstances of this case, it is no defense to show that those filing the proxy statement were motivated by loose talk on the part of a government employee. Responsibility for the adequacy of proxy materials is imposed upon those soliciting the shareholders' votes, and not upon government employees who perform what is basically a police function. Defendants had the duty to stand up to the staff member if his suggestions were without merit. Indeed, they did so vigorously and successfully with regard to at least one other suggestion.[7]

6. Effective September 1, 1974, still another contract was entered into between the Fund and its adviser. This contract was ratified at a shareholders' meeting held in July, 1974. The validity and effect of this contract and the proxy statement used in connection with the shareholders' meeting at which it was ratified are not in issue in this case.

7. The same staff member apparently attempted to induce the Fund to inform its shareholders that it paid higher fees to its Adviser than most other funds. This attempt was rejected by defendants' counsel. See Ex. 11 and Tr. p. 9, *et seq.* A memorandum dated June 15, 1973 (Ex. 11) written by Douglas Crum, an attorney employed by Chestnutt Corporation, states that "They [the SEC staff] were basing this statement solely on the rate on the first $50 million [of assets]—and not on any actual calculation of the ef-

Plaintiff also complains of a failure to accede to a request made by the SEC staff to insert a statement in the proxy materials to the effect that the Fund's fees were higher than those paid by similar funds, and a failure to advise the Fund's non-affiliated directors of the SEC's request and of the fact that the fees were high. As to these complaints the Court finds no merit in plaintiff's contentions.[8]

[13] I find that the statements quoted above are false and misleading. The proposed increase in the expense ratio was not the "result of cost increases over which the Fund nor the Adviser can exercise control," but was primarily the result of the decreasing net asset value of the Fund. The statement that "No higher fees or costs would have been incurred by the Fund had the proposed new Agreement been in effect in 1972" (Ex. 2, p. 6) represents a misleading half-truth and omission in that it fails to disclose that if the old agreement had remained in effect for its unexpired term, a refund would have been due the Fund in 1973.

The paragraph in its entirety is as follows (emphasis added):

> *"As a result of cost increases over which nether the Fund nor the Adviser can exercise control*, the Fund and the Adviser have determined that the 1% annual expense ratio limitation in the current Investment Advisory Agreement shall be increased to 1½%. No increase in the fees paid or payable to the Adviser is proposed. The aggregate of annual operating costs, including the fee of the Adviser, will be limited to 1½% of average monthly net assets in the contract. Heretofore, the Advisory Contract required the Adviser to reimburse the Fund to the extent that total annual expenses (exclusive of interest and taxes) exceeded 1% of average monthly net assets. Under the new agreement, no reimbursement from the Adviser would be required unless and until total annual expenses of the Fund (again, excluding interest and taxes) exceeded 1½% of average monthly net assets. The Investment Advisory fee schedule would not be changed under the new agreement; however, the higher allowable expense ratio limitation would benefit the Adviser by reducing the risk that some or all of the advisory fee would have to be reimbursed to the Fund due to an increase in rates for other expenses or changes in the average account size of American Investors Fund shareholders. *No higher fees or costs would have been incurred by the Fund had the proposed new Agreement been in effect in 1972.*"

With regard to the first statement italicized above, the shareholders should have been told it was the combination of decreasing net asset value and increasing expenses which resulted in a "risk" that the adviser would have to reimburse the Fund. The paragraph as a whole, particularly with the addition of the last sentence, is misleading. That a

fective [overall] rate on current levels of [total] assets."

Mr. Cram stated that he knew of no study of the effective rates charged other funds, and requested that the SEC suggest such a study to him. The SEC apparently made no such suggestion, and the matter was dropped.

The fees paid Chestnutt Corporation are computed on a decreasing scale, as follows:

.8 of 1% on the first $50 million
.6 of 1% on the next $50 million
.4 of 1% on the next $200 million
.35 of 1% on the next $200 million
.3 of 1% on net assets in excess of $500 million.

The effective overall rate obviously depends on the current net asset value of the Fund. Exhibit 14 shows that the advisory fees paid by 14 of the 21 funds listed with rates beginning at .5 of 1% and then decreasing could under no circumstances exceed the fees paid by AIF. With its assets at approximately $150,000,000.00 in mid-1973, the effective rate AIF paid Chestnutt Corporation was .6%. In 1972, however, with net assets at $220,000,000.00, the rate would have been lower.

8. See footnote 10 hereof.

refund might be due in 1973 if the old contract remained in effect for the balance of its agreed term of two years was material "in the sense that a reasonable investor might have considered (it) important," *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153–54, 92 S.Ct. 1456, 1472, 31 L.Ed.2d 741 (1972); *Mills v. Electric Auto-Lite*, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970); *Schlick v. Penn-Dixie Cement Corporation*, 507 F.2d 374 (2d Cir. 1974), in deciding whether to vote in favor of ratification of the proposed new advisory contract.

The quoted paragraph gives no indication whatever that a refund was ever even a remote possibility, under any likely set of foreseeable circumstances, including rejection of the proposed new agreement. In this regard, it was misleading, and false. There is no doubt that Mr. Chestnutt and the other interested directors thought a rebate was likely, or they would not have sought an increase in the expense ratio. The importance they attached to this likelihood is "a major factor in determining whether (it) was a material fact." *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 851 (2d Cir. 1968).

[14] The Court finds defendants breached the provisions of § 14(a) of the Securities Exchange Act [15 U.S.C. § 78n(a)] and Rule 14a–9 promulgated thereunder, by omitting to disclose in the June 21, 1973 proxy solicitation that the change in the advisory contract might result in loss of a foreseeable rebate to the Fund in the period September 1, 1973 through August 31, 1974. By the terms of § 20(a) of the Investment Company Act [15 U.S.C. § 80a–20(a)], a violation of § 14(a) of the Securities Exchange Act is also a violation of § 20(a) [*Monheit v. Carter*, 376 F. Supp. 334, 340 (S.D.N.Y.1974)]. Therefore, pursuant to 15 U.S.C. § 80a–46, this violation of § 20(a) of the Act also renders the new contract void and unenforceable against the Fund, insofar as concerns the increase in the expense ratio limitation.

Demand Requirement of Rule 23.1, F.R. Civ.P.

[15, 16] Defendants suggest plaintiff may not prevail because of failure to make a timely demand on the directors. See Rule 23.1 F.R.Civ.P.; New York Bus.Corp.Law § 626(c), McKinney's Consol.Laws, c. 4. Important public policies require that the management of a corporation be entrusted in the first instance to the discretion of its directors. To protect these policies, and prevent the initiation and maintenance of strike suits brought solely to humiliate defendants and extract legal fees, such demands followed by refusal are ordinarily a condition precedent to derivative litigation. Here, clearly, demand would have been fruitless and accordingly is excused as unnecessary. Defendants resisted, tenaciously and effectively, plaintiff's attempt to enjoin the shareholders' meeting. This, and their defense of this litigation, taken together with the fact that their own proxy statement and their own acts were brought directly in question by plaintiff's claims, warrants a finding that any preliminary demand on the Fund or its directors would have been futile. *Papilsky v. Berndt*, 59 F.R.D. 95 (S.D.N.Y.1973).

Expiration Date of Old Contract.

Defendants contend, based on their interpretation of paragraph 9 thereof, that the original advisory contract would have expired on June 30, 1974, rather than August 31st. That portion provides (Ex. 4, p. 14):

> "The Corporation (Fund) agrees to pay to the Investment Adviser and the Investment Adviser agrees to accept as full compensation for all services rendered by the Investment Adviser hereunder for each of the Corporation's fiscal quarters on the last day of each quarter, a fee in an amount determined by applying the following quarterly rates to the value of the Corporation's net assets at the end of

each calendar quarter: * * * provided, however, that the annual fee of the Investment Adviser shall not be more than an amount which, when added to the other charges of the Corporation (exclusive of interest and taxes) shall result in total charges per annum to the Corporation inclusive of the fee of the Investment Adviser (but exclusive of interest and taxes) of 1% of the value of the Corporation's average monthly net assets for any year. For the first quarter in which this Agreement shall be in effect, the foregoing computations shall be made as if this Agreement was in effect for the entire quarter. For the quarter and the year in which this Agreement terminates, there shall be an appropriate proration on the basis of the number of days that this Agreement is in effect during the quarter and the year respectively. . . ."

[17] It is not clear how defendants derive a June 30, 1974 expiration date from this paragraph.[9] The contract is dated "as of September 1, 1972" and paragraph 11 provides (Ex. 4, p. 15):

"This agreement shall remain in effect for a period of two years from the date hereof. . . ."

Thus, the expiration date of the contract is clearly August 31, 1974, and the 1% expense ratio limitation must be applied for the periods during which the contract would have been in effect.

[18] Defendants complain that such an interpretation would have the effect of providing for an expense limitation of 1% for part of calendar 1974 and a 1½% limitation for the latter part of calendar 1974, a result not contemplated by the parties. Whether the parties contemplated such a result or not, the agreement is so drafted by competent attorneys, it is not ambiguous, and must be construed as it is written.

[19] The Fund kept its books and rendered its financial statements quarterly, on a calendar year basis. According to paragraph 9, computations are to be made *as if* the agreement had been in effect on July 1, 1972, but that does not imply the fee would be paid from July 1st, nor does it imply the agreement was in effect on July 1st. Paragraph 9 explicitly provides that when the agreement terminates, the fee and expense limitation shall be prorated "on the basis of the number of days that this agreement is in effect during the quarter and the year respectively." Any such need to prorate would be obviated if the agreement terminated on June 30th, which is the end of a quarter. We will not assume the parties included gratuitous language in so vital a section of the agreement as the advisory fee paragraph.[10]

9. The Annual Report of American Investors Fund, Inc. for December 31, 1973 (Ex. 13) "Notes to the Financial Statements, Note 3", discusses the effect of the new agreement as follows:

"At the Annual Meeting of Shareholders held on July 17, 1973 the shareholders approved a new investment advisory agreement for a term of two years effective September 1, 1973 *retroactive to July 1, 1973*. The new agreement is similar in all respects to the prior agreement with the exception of the limitation ratio of expenses as related to average monthly net assets which was increased to 1½% from 1% as provided in the prior agreement. Accordingly, *the adviser is required to refund each year any amount by which total expenses of the Fund*, exclusive of taxes and interest, *exceed 1½% of average monthly net assets for the period July 1, 1973 to December 31, 1973 and 1% of average monthly net assets for the period January 1, 1973 to June 30, 1973.*" [Emphasis supplied.]

There is no justification in either of the contracts for such an interpretation. Specifically, nowhere in paragraph 9 or elsewhere is there a provision that the contract shall be retroactive to July 1, 1973.

10. Conceivably if the contract had been terminated prior to expiration, by giving sixty days notice, or by impossibility of performance

[20] Reading the paragraph as a whole, it can only mean the first payment to the adviser under the contract was not to be computed on the basis of the average net asset value of the Fund for the month of September only, but on the basis of a figure representing an average of the net asset values for each of the three months in the quarter, July 1st through September 30th.

Damages; AIF Counsel Fees.

[21] Equity requires that counsel fees paid or accrued by AIF as expenses for outside attorneys solely for the purpose of this litigation should not be considered as expenses in applying the 1% limitation. As to 1973, it is apparently not disputed that Philadelphia counsel were paid a special retainer of $7,500.00 in connection with the proceedings before Judge Broderick. The Court is requested to allocate $2,000.00 of Mr. Cram's time and $15,000.00 of the billings of general counsel directly to this case.

As to Mr. Douglas Cram, who is described as the Fund's "resident counsel" (Def. Post-Trial Memo., p. 17), the Court declines to allocate any portion of his salary as requested. It is doubtful that the Fund's expenses would be diminished in any amount had Mr. Cram been otherwise engaged.

We are asked (*ibid*, p. 17) to "view $15,000.00 of the $43,735.00 paid to (the Fund's general counsel) for legal services in 1973 to the important function of protecting the rights of 100,000 shareholders to exercise their franchise and have their annual meeting." This we would not be inclined to do unless it could be shown that a specific amount was separately billed and paid in 1973 solely by reason of this action. Since, as will appear below, it is necessary to take additional evidence by stipulation or otherwise, we leave it open to defendants to show how much of the 1973-74 legal expenses are directly attributable to this action and would have been avoided but for the litigation. Plaintiff may not, in good conscience, be the one who pulls the trigger bringing the override provisions into effect.

Plaintiff, by bringing this action in Philadelphia on the eve of the 1973 shareholders meeting, forced the Fund to incur attorneys' fees to assure that the shareholders' meeting would go forward, and avoid the threatened expense of cancelling and rescheduling the meeting. Plaintiff sought an injunction to which she was held not entitled, pursuing that remedy in an inappropriate venue. Plaintiff is partly responsible for AIF's expenditure of counsel fees and the size thereof, at least before the case was transferred to this District. In addition, research discloses no cases in point decided under 15 U.S.C. §§ 80a-35(b), as amended in 1970, and therefore novel issues were raised by this suit. The Court finds this case was defended, here and in Philadelphia, in good faith.

The parties agree no refund would have been due AIF in 1972. Therefore, 1972 is excluded from the damage computation.

Since the expense limitation is to be computed for every calendar year or portion of a calendar year covered by the agreement, damages must be computed first for all of 1973, then separately for January 1, 1974 through August 31, 1974.

Through no fault of counsel to any party, the Court is unable to fix the damages for that portion of 1974 abovementioned. Because the parties assumed validity of their own differing interpretations given the old contract, the record does not contain sufficient information upon which the Court may make an award including those months. This

supervening illegality, force majeure, etc., the pro-ration clause would be useful. But its plain meaning is not limited to such premature termination.

is so notwithstanding agreement made with the Court at the trial (Tr. p. 183).

Conclusion.

Counsel are requested to submit a stipulation in writing setting forth the applicable amounts in accordance with this opinion, or if such a stipulation cannot be mutually agreed upon, so to advise the Court within twenty (20) days from the date hereof so consideration may be given as to how such data may be elicited.

The foregoing constitutes findings of fact and conclusions of law pursuant to Rule 52, F.R.Civ.P.

SUPPLEMENTAL FINDINGS AND CONCLUSIONS

Prior findings and conclusions filed herein July 23, 1975, are modified and amplified as hereinafter set forth.

The correct figure for 1973 average net assets is $166,058,784.00. The 1% limitation based upon this amount would be $1,660,587.00.

The Court approves the practice followed in taking the sum of 13 figures and dividing by 13 to obtain the average monthly assets for the year 1973. This is the method which the Fund has used for many years prior to the commencement of this litigation, and may be regarded as having been within the contemplation of the parties when the contract sued upon was signed. It is not totally unreasonable. The alternate method suggested by plaintiff would in effect give consideration only to end of month dates for eleven months, and would produce a distorted and unreasonable result.

Plaintiff has consented to deduct from expenses for 1973 the sum of $12,500.00 as attorneys' fees directly attributable to this litigation. This includes $7,500.00 paid to Philadelphia counsel, and $5,000.00 allocable to general counsel to the Fund. The Court regards these sums as reasonable. The fee of Philadelphia counsel was fixed and paid at arms length. While general counsel invested additional time in the matter, much of it concerned conferences with Philadelphia counsel, and duplicative work performed jointly with Philadelphia counsel. Furthermore, the same attorneys were, at least indirectly, representing the interests of Chestnutt and his corporation at the same time. Under all the circumstances present here, an allowance of $5,000.00 is reasonable and adequate.

Accordingly, the damages for 1973 are to be computed as follows:

Expenses net of interest and taxes per Ex. 15, p. 3	$1,691,417.00
Less: Legal Fees	12,500.00
	$1,678,917.00
Subtract, 1% limitation.	1,660,587.00
Rebate for 1973 (Damages) $	18,330.00

With respect to the damages for that portion of 1974, the agreement clearly contemplated a pro rating of expenses through its termination. See p. 26, *et seq.* and fn. 10 of Findings and Conclusions dated July 23, 1975.

Generally accepted accounting principles consistently applied must be followed. This requires accruals where appropriate. For purposes of the advisory agreement, expenses are expenses, and there is no provision therein excluding unusual or non-recurring expenses. The Fund spent substantial amounts in 1974 to liquidate the holdings of small shareholders in order to save future expenses. To the extent the Fund treated those costs as expenses during the applicable period, they remain just that. The Court sees no basis to require the exclusion of those items from the damage computation, and will treat the accrual in the third quarter as a *pro rata* expense.

As to 1974 legal fees, we are advised that no bill has been rendered to the advisor, represented, properly, by the

same counsel in the subsequent trial. Recognizing the stakeholder status which the Fund acquired as soon as the injunctive aspect of this litigation was resolved, the Court finds, solely for the purposes of this computation, that the sum of $3,000.00 is a reasonable amount to pay for its representation in this litigation during the first eight months of 1974, and will treat that sum as being exempted from the expenses subject to the limitation.

The rebate for the first eight months of 1974 is calculated as follows:

Expenses for 1st six months on accrual basis, net of interest and taxes		$ 800,204.00
Redemption program accrued (⅔ x 39,068.73)		26,045.82
Advisory fee accrued for July and August (Schedule attached to 8/15/75 letter from Chestnutt's counsel to plaintiff's counsel)		104,851.00
Total		$ 931,100.82
Total [carried forward]		$ 931,100.82
Less allowance for legal expenses		— 3,000.00
		$ 928,100.82
Expense Limitation (¶13 of Defendant's post trial exhibit at 8 months basis, or ⅔ths of 1%)		—869,758.80
Rebate for 1974 (Damages)	$	58,342.02

The Court declines as a matter of discretion to award pre-judgment interest.

Settle a final judgment on five (5) days notice in favor of American investors Fund, Inc. and against Chestnutt Corporation, in the amount of $76,672.00. The judgment may contain appropriate provisions retaining jurisdiction to award legal fees and disbursements to Plaintiff out of the recovery following appellate finality, and upon notice.

Florence A. COEN, Plaintiff,

v.

BOULDER VALLEY SCHOOL DISTRICT NO. RE-2, IN the COUNTY OF BOULDER and STATE OF COLORADO et al., Defendants.

Civ. A. No. C-5433.

United States District Court,
D. Colorado.
Oct. 30, 1975.

Action was brought by nontenured teacher, whose contract had not been renewed, for order restoring her teaching position and for recovery of damages. The District Court, Chilson, J., held that evidence did not support teacher's claims that evaluations, comments and criticisms made concerning her teaching deprived her of liberty without due process of law or infringed her First Amendment rights, and that where question whether teacher had property right under state law in continued employment of which she could not be deprived without due process of law involved state law questions which had not yet been answered by Colorado state courts, court would abstain from further proceedings in connection with such claim to allow teacher to litigate state law questions in state courts.

Action dismissed in part with prejudice and in part without prejudice.

1. Schools and School Districts ⇨133.15

Evidence in action brought by nontenured teacher, whose contract had not been renewed, for order restoring her to teaching position and for recovery of damages, did not support her claims that evaluations, comments and criticisms, which were made concerning her teaching and which did not contain, inter alia, any charges that might seriously damage her standing in community nor suggestions that she was dishonest or immoral, deprived teacher of her liberty

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MILDRED GALFAND, on behalf of herself and on behalf of AMERICAN INVESTORS FUND, INC.,

Plaintiff,

-against-

GEORGE A. CHESTNUTT, JR., and CHESTNUTT CORPORATION,

Defendants,

-and-

AMERICAN INVESTORS FUND, INC.,

Nominal Defendant.

73 Civ. 3849-CLB

FINAL JUDGMENT

MICROFILM Dec 18, 1975

WF
US District Court Filed Dec 15 1975 SD of NY

This action came on for trial before the Court, Honorable Charles L. Brieant, Jr., District Judge, presiding, and the issues having been duly tried, and a decision having been duly rendered upon prior findings and conclusions filed herein July 23, 1975 and upon supplemental and corrected findings and conclusions filed herein November 11, 1975,

IT IS ORDERED AND ADJUDGED

That the nominal defendant, American Investors Fund, Inc. recover of the defendant Chestnutt Corporation the sum of $76,672.00 without interest, prior to judgment, and

IT IS FURTHER ORDERED AND ADJUDGED

That this Court retain jurisdiction to award legal fees and disbursements to plaintiff out of the recovery when the foregoing judgment shall have become final, following ap-

pellate review, if any, and upon ten (10) days notice.

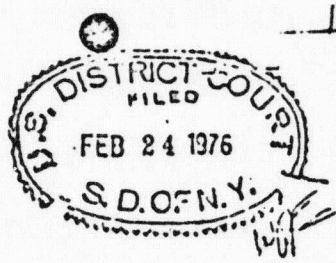
Dated: New York, New York
December 12, 1975

Charles L. Brieant Jr. (Signature)
CHARLES L. BRIEANT, JR.
U. S. D. J.

Judgement Entered 12-17-75

Raymond F. Burghardt

Docket Entry



copy mailed by Judge Feb 25, 1976

Endorsement

MILDRED GALFAND, on behalf of herself and on behalf of AMERICAN INVESTORS FUND, INC., Plaintiff v. GEORGE A CHESTNUTT, JR., and CHESTNUTT CORPORATION, Defendants, -and- AMERICAN INVESTORS FUND, INC., Nominal Defendant. 73 Civ. 3819-CLB

The within motion for a (further) amendment to the Court's Supplemental and Corrected Findings and Conclusions filed November 11, 1975, and the judgment herein, is denied.

The Court has serious misgivings as to the correctness of the computation of damages awarded, and believes it is not inconceivable that the nominal defendant, American Investors Fund, Inc., may be entitled to a slightly higher recovery against its adviser.

The accounting information upon which to make a precise analysis and determination of this amount has not been presented clearly to this Court. A Court is not required, under the circumstances of this adversary litigation, to conduct an audit, or make any extensive analysis of the underlying accounting data. It need only find such damages as are clearly and unquestionably shown by the evidence. This has been done.

All litigation must eventually reach a point of termination, beyond which further refining adjustments and corrections are not required. A litigant is entitled to his day in Court, but a time must come in all lawsuits where the parties must move on to the next (appellate) arena. "[A]fter a party has had his day in court, justice, expediency and the preservation of the public tranquillity requires that the matter be at an end." Schroeder v. 171.4 Acres of Land, etc., 318 F.2d 311, 314 (8th Cir. 1963).

The Court declines to entertain any further requests for corrections, additions or refinements to the Judgment, or to do anything further in this action, and respectfully commends these indefatigable but inexact litigants to the Court of Appeals for such directions as it may wish to make in the matter.

So Ordered.

Dated: New York, New York
February 23, 1976

Charles L. Brieant
CHARLES L. BRIEANT
U. S. D. J.

MICROFILM FEB 24 1976

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MILDRED GALFAND, on behalf of herself and on behalf of AMERICAN INVESTORS FUND, INC.,

Plaintiff,

-against-

GEORGE A. CHESTNUTT, JR., and CHESTNUTT CORPORATION,

Defendants,

-and-

AMERICAN INVESTORS FUND, INC.,

Nominal Defendant.

73 Civ. 3849-CLB

NOTICE OF APPEAL

Notice is hereby given that defendant Chestnutt Corporation hereby appeals to the United States Court of Appeals for the Second Circuit from the final judgment entered herein on the 17th day of December, 1975.

Dated: New York, New York
March 19, 1976

Clendon H. Lee

Clendon H. Lee
Attorney for Chestnutt Corporation
90 Park Avenue
New York, New York, 10016
Tel. (212) 953-9200

TO: The Clerk:

United States District Court
Southern District of New York
United States Court House
Foley Square
New York, New York

attorney(s) for that purpose by depositing a true copy of same enclosed in a postpaid properly addressed wrapper, in a post office or official depository under the exclusive care and custody of the United States Post Office Department within the State of New York.

KREINDLER & KREINDLER, ESQS.
Attorneys for Plaintiff
99 Park Avenue
New York, New York 10016
Tel. (212) 687-8181

TO:

ROGERS & WELLS, ESQS.
Attorneys for American
Investors Fund, Inc.,
Nominal Defendant
200 Park Avenue
New York, New York 10017
Tel. (212) 972-7000

Original
Filed
3-25-76
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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MILDRED GALFAND, on behalf of herself and on behalf of AMERICAN INVESTORS FUND, INC.,

Plaintiff,

-against-

GEORGE A. CHESTNUTT, JR., and CHESTNUTT CORPORATION,

Defendants,

-and-

AMERICAN INVESTORS FUND, INC.,

Nominal Defendant.

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73 Civ. 3849 (CLB)

NOTICE OF CROSS APPEAL

RECEIVED
MAR 23 1976
BY MAIL
ROGERS, HOGE & HILLS

Notice is hereby given that Mildred Galfand, the plaintiff in the above-entitled action, hereby cross appeals to the United States Court of Appeals for the Second Circuit from the Final Judgment entered herein on December 15, 1975 and from the Order filed herein on February 24, 1974 denying plaintiff's motion pursuant to Rule 52(b) for an amendment to the Court's Supplemental and Corrected Findings and Conclusions and Final Judgment.

Dated: New York, New York
March 15, 1976

KREINDLER & KREINDLER

By _____
A Member of the Firm
Attorneys for Cross-Appellant
99 Park Avenue
New York, New York 10016

To: Rogers, Hoge & Hills
90 Park Avenue
New York, New York 10017
Attorneys for Appellants
George A. Chestnutt and
Chestnutt Corporation

- and -

Rogers & Wells
200 Park Avenue
New York, New York
Attorneys for the Nominal
Defendant American Investors
Fund, Inc.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MILDRED [illegible], Plaintiff, vs. GEORGE A. CHESTNUTT, JR., Defendant.	Before: HON. CHARLES L. BRIEANT, JR. District Judge.
	73 Civil 3849

New York, February 18,19, 1975

STENOGRAPHER'S MINUTES

BEST COPY AVAILABLE

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

- x

MILDRED GALFAND, :

Plaintiff, :

-against- : 73 Civil 3849

GEORGE A. CHESTNUTT, JR., :

Defendant. :

- x

February 18, 1975,
10 A.M.

Before:

Hon. Charles L. Brieant, Jr.,
District Judge.

Appearances:

KREINDLER & KREINDLER, ESQS.,
Attorneys for Plaintiff,
By: Ronald Litowitz, Esq., and
Edward A. Grossmann, Esq., of Counsel.

ROGERS HOGE & HILLS, ESQS.,
Attorneys for Defendant,
By: Clendon H. Lee, Esq., of Counsel.

MR. LITOWITZ: Good morning, your Honor.

THE COURT: Good morning. You are Mr. Litowitz?

MR. LITOWITZ: I am Mr. Litowitz of the firm of Kreindler & Kreindler representing the plaintiff, and assisting me today, also from Kreindler & Kreindler, is Mr. Edward Grossmann.

THE COURT: Are you ready to start?

MR. LEE: Yes, your Honor.

THE COURT: If you desire to exclude fact witnesses who are in the back, who are not officers or directors of the parties, you may ask to have them excluded when we proceed with the taking of testimony.

MR. LITOWITZ: Thank you, your Honor.

We sent down a pre-trial order on Friday which contained a stipulated statement of certain of crucial facts of the case.

THE COURT: Yes. I have it before me.

MR. LITOWITZ: Attached to that stipulation as Exhibit A is a list of exhibits marked on the depositions, Exhibits 1 through 24, all as Defendant's Exhibit A.

And annexed as Exhibit B are the dates and names of the persons deposed by plaintiff in the litigation.

In the stipulation, as paragraphs 27 and 28, we stipulated with respect to the authenticity of the exhibits

and reserved our rights to any objections as to relevance.

THE COURT: That's my normal procedure.

MR. LITOWITZ: Yes. Now, if your Honor would like, rather than take the time of the Court, we would like to just put in seriatim the exhibits marked on the deposition by plaintiff, and also mark as exhibits the actual deposition transcripts taken by plaintiff.

If Mr. Lee at this point would like to raise his objections or indicate he has none, we could do that and I believe it would save the time of the Court and all parties.

MR. LEE: I am all in favor of what Mr. Litowitz suggests: marking the exhibits and the depositions.

THE COURT: All right. All of them have to be read anyway and the Court will reserve decision at the close of the hearing. I will take post-trial memoranda so you may proceed on that basis.

MR. LITOWITZ: Your Honor, again, another suggestion if we may. If we could just proceed now with the witnesses and possibly mark these at a break --

THE COURT: That you may do also.

MR. LITOWITZ: Because we all know the identity of the depositions and also of the exhibits.

THE COURT: All right.

MR. LITOWITZ: Accordingly I will call as our

first witness Mr. Douglas Cram.

D O U G L A S M. C R A M, called as a witness, having been duly sworn, testified as follows:

MR. LITOWITZ: Your Honor, one thing I forgot. We had also signed an additional stipulation which I would like to hand up. That goes to the statistical data on which plaintiff bases its claim for damages.

DIRECT EXAMINATION

BY MR. LITOWITZ:

Q Mr. Cram, could you state your home address, please?

A 32 Sawmill Lane, Greenwich, Connecticut, 06830.

Q Can you tell us by whom you are currently employed?

A Pepsico, Inc.

Q Tell us the nature of your employment.

A I am counsel, corporate counsel in the soft drink division.

Q Can you tell us your educational background, please, starting with college?

A I was graduated from the University of Minnesota, Phi Beta Kappa, magna cum laude, in 1965, and Harvard Law School in 1968.

Q Will you trace your employment from the time you graduated from law school, please?

A My first job was with a firm in New York by the name of Wachtell, Manheim & Grouf at 30 Rockefeller Plaza from September 9, '68, through April of 1969.

I believe there was no interval between my employment with Wachtell, Manheim & Grouf and the time I took a position as an attorney for American Investors Fund, so that was either the end of April, 1969, or the beginning of May, 1969, until the end of August of 1973 when I was first attorney and later general counsel of American Investors Fund and Chestnutt Corporation, the investment adviser to American Investors Fund.

I am now with Pepsico. I was originally an attorney and I am now a corporate counsel.

Q Mr. Cram, I show you Exhibit 2 marked on the depositions of the proceedings herein and ask you if you can identify that exhibit.

THE COURT: Is that in dispute?

MR. LITOWITZ: It is the proxy statement.

THE COURT: Offer it in evidence. Don't waste time handing him identifying documents which your adversary doesn't dispute.

MR. LITOWITZ: It is in evidence. I am just going to ask him a few questions about it.

A It purports to be the proxy statement.

THE COURT: Is it or isn't it?

THE WITNESS: It is Xeroxed. It is not bound by the printer. I am not trying to be contentious.

THE COURT: All right. May we have a concession on the record. What is this paper that's been handed to the witness.

THE WITNESS: I mean, I have one that I brought with me.

THE COURT: You keep quiet. When you are addressed, you answer.

MR. LEE: Your Honor here is a printed copy.

THE COURT: All right. Mark it.

MR. LITOWITZ: Mark this as Exhibit 25, please.

(Plaintiff's Exhibit 25 was marked for identification.)

xx

Q Mr. Cram, can you identify Exhibit 25 marked for identification, please?

A It is the 1973 proxy statement.

Q Of American Investors Fund?

A American Investors Fund, yes.

MR. LITOWITZ: I offer that into evidence as Exhibit 25.

MR. LEE: No objection.

THE COURT: Received in evidence.

(Plaintiff's Exhibit 25 for identification was received in evidence.)

xx

Q Mr. Cram, did you have any part in drafting Exhibit 25?

A Yes, I did.

Q Can you tell us what your role was in the drafting of Exhibit 25?

A To prepare a proxy statement which complied with the proxy rules under the '34 Act, the '40 Act, and which adequately informed shareholders of the Fund of the matters to be acted upon.

Q By that do you mean that you were the principal author of Exhibit 25?

A That would be correct.

Q Did anyone else assist you in the drafting of Exhibit 25?

A Well, I'm sure that Mr. Lee and I discussed matters from time to time. I am sure Mr. Chestnutt and I discussed matters from time to time.

Q When you say Mr. Lee, could you identify Mr. Lee, please?

A Mr. Lee is Clendon Lee who has been counsel for, an outside counsel for American Investors Fund and Chestnutt Corporation for many years.

Q Mr. Cram, I show you Exhibit 11 which has previously been marked in the depositions of these proceedings. I ask you if you can identify that as a memorandum that you wrote.

THE COURT: I'm not going to have any papers identified unless there is a dispute about them. You are not going to waste my time with that kind of material. If these matters are stipulated under the pre-trial order, offer them in evidence. If there is an objection to relevance I will hear it but their authenticity is supposed to be resolved before you get here.

MR. LITOWITZ: It has been, your Honor.

THE COURT: All right, then offer it in evidence.

MR. LITWOTIZ: I thought --

THE COURT: Don't think. Don't waste time. Offer the document.

MR. LEE: Your Honor, we will stipulate that all of the exhibits set forth be introduced in evidence at this point and that they may be referred to and they may be marked subsequently.

THE COURT: All right, the clerk will mark them for you at the next recess and they are all received in evidence everything listed under Exhibit A attached to the pre-trial order dated today.

Q Mr. Cram, I will show you Exhibit 11 and I call your attention to paragraph 9 thereof. I ask you to explain the circumstances of your writing of the paragraph 9.

A I had a conversation with, I guess, a staff attorney. I am not sure what his position was. He asked me to place in the proxy statement a statement the accuracy of which was subject to substantial doubt.

Q What was the statement the staff member of the SEC asked you to place in the proxy statement?

A I don't recall the exact words but let me read the paragraph and it may help me to refresh my recollection.

Q Could you read it out loud?

THE COURT: No. No exhibit may be read out loud. If he wants to read it quietly to refresh his recollection, he may.

(Pause.)

A This individual on the staff of the Commission asked that the Fund state in its description of the advisory contract that the advisory fee which shareholders were being asked to approve was higher than that paid by most funds to their manager-advisers.

Q Did you take issue with the person at the SEC that made that statement?

A Yes.

Q Can you tell us what you said to him?

A I objected to that on two bases: first of all, I said that we had never seen a study that indicated that the effective rate of compensation to the manager-adviser was in excess of a weighted average or a mean average or a median average of the rates paid by other funds to other management companies.

The American Investors Fund fee schedule is unusual in that it starts at .8 per cent but drops at the first $50,000,000, the first break point. It is highly unusual. Most break points are at much higher levels or in the case, I believe, of Dreyfus, it never drops. I'm not sure that that's the name of the fund but there is a $3,000,000 fund or there was at that time where there was no break point at all so you get a misleading view by looking at the .8.

I then also informed him that when you do not look at total compensation, i.e., compensation which also includes load fees paid by the shareholders of load funds, you get a misleading view of the compensation being received by the investor, and that I would not put in a statement which I considered to be misleading at his suggestion.

Q Mr. Cram, did you use the term"effective rate of compensation"for the Fund?

A Yes.

Q Do you recall the effective rate of the compensation to Chestnutt Corporation by American Investors Fund during the period of May and June, 1973?

MR. LEE: Objection as to form.

THE COURT: Does he recall? He can answer yes, he does recall or no, he doesn't recall.

MR. LEE: Your Honor, there is no such thing as an effective rate at a particular period.

THE COURT: That's an element for cross-examination. I will overrule the objection.

A No, I don't.

THE COURT: All right.

Q I show you Exhibit 15 and I call your attention to the figures set out for May and June of 1973 and ask you if based on that that refreshes your recollection as to the effective rate of compensation to Chestnutt Corporation?

A No, it does not.

Q Can you explain to us what the effective rate of compensation would be to Chestnutt Corporation if the Fund had net assets of $150,000,000?

A I would have to compute it.

Q Could you do that?

A It is 8/10 on the first 50,000,000; 6/10 on the

next 50. And 4/10 - is that right? I don't recall now for sure. I believe it drops to 4/10 between 100 and 300 million, so that would be 6/10 of 1 per cent on that asset base if my assumptions are correct about the rates and the break points.

Q Now, if the net asset values fell below $150,000,000, would the effective rate then exceed .6 of a per cent?

A Yes, it would. If my assumptions are correct, it would.

Q Mr. Cram, I show you Exhibit 14B, which has been previously marked, and I call your attention to the varying rates of compensation indicated thereon.

I ask you if you are familiar with the funds indicated on Exhibit 14B?

A I have heard of all of them, yes.

Q During the period of May and June, 1973, were you familiar with the rates of compensation to these advisers by the funds enumerated on Exhibit 14B?

A I wouldn't have been able to recite them from memory but yes, I was vaguely familiar with them. I had looked at them several times in a compendium published annually.

Q Which one is that?

A There are several. The one I recall most easily

is the Mutual Fund Guide. I believe it is published by Fundscope, is that correct? It is a thick, brown issue, reddish-brown covered book, paper covered, and it sold for $15, as I recall.

Q Looking at the far right column on Exhibit 14B, can you tell us whether the effective rate of compensation payable to Chestnutt Corporation on net assets of $150,000,000 exceeded most or all of the funds indicated on Exhibit 14B?

A No, I couldn't tell you that. That doesn't indicate what the break points are nor does it indicate the size of the fund. If a $3,000,000 fund had a - let's take the second fund on the list, Babson. Now Bason would be high, would have a higher compensation rate to its manager-adviser at all rates after, I believe, $75,000,000 because at that rate the American Investors Fund average would fall below .75 as the .6 on the second 50,000,000 became increasingly important vis-a-vis the .8 on the first 50,000,000. Those are just the first two.

Going further down the list we have no way of knowing what the fifth fund is. We don't know what the break points are. That could be higher.

The next one could be higher.

Q Looking at the funds where the starting figure is either .5 of a per cent or .6 of a per cent, could those

fees, under any circumstances, be higher than the fee paid by American Investors Fund at the $150,000,000 level?

A It couldn't be higher, I would not think.

Q So compared to those groups of funds appearing on Exhibit 14B, American Investors Fund's effective rate of compensation was higher than all those funds indicated?

A Or equal to.

Q In which case would it be equal to?

A On $150,000,000, the effective rate of compensation would be .6, so it would be equal to, for example, Nicholas Strong Fund, unless you knew what its break points were.

Q And American Investors Fund would be higher than the Johnston Fund which starts at .5 of a per cent?

A Yes.

Q And it would be higher than the Loomis Fund that starts at .5 of a per cent?

A Yes, it would.

Q And it would be higher than the - is that the Mathers Fund?

A Yes.

Q That begins at .5 of a per cent?

A Yes.

Q And it would be higher than every other fund indicated that begins at .5 of a per cent or lower; would that

be correct?

A That would be correct.

Q In your telephone conversation with the gentleman from the SEC did you indicate that you could not find any information on the issue of whether the Fund paid a higher rate than other funds?

A No.

Q Did you tell him that you would undertake to make such a study?

A No, I specifically declined to make such a study.

Q How many different telephone conversations did you have with the SEC concerning this issue?

A One, I believe. I believe the conclusion was that I would state in my transmittal of the final copies of the proxy statement that we declined his suggestion and there were no further discussions.

Q Did you discuss with Mr. Clendon Lee your discussion with the gentleman at the SEC regarding the SEC suggestion?

A We went over each point.

Q What did Mr. Lee say about responding to the SEC's position on this issue of the higher fee?

A I don't have a specific recollection although I must say that, from the fact the letter went out, we were

in agreement by the time the letter went out.

Q Do you recall whether you met with Mr. Lee to discuss this or did you discuss this on the telephone?

A It was frequently in the offices of American Investors Fund but whether I discussed it on the phone or whether I saw him I cannot confirm to you.

Q Who else did you discuss this telephone conversation with?

A (No response.)

Q The conversation I am referring to now is that with the SEC concerning the higher rate of compensation.

A Of course I would have discussed it with Mr. Chestnutt. Mr. Chestnutt was the president of American Investors Fund.

Q Did you discuss it with any other directors of American Investors Fund?

A I have no specific recollection of discussing Rondeau's comment with directors of the Fund. We have from time to time either before or during the course of the directors' meeting discussed that type of response.

MR. LITOWITZ: Please mark for identification as Exhibit 27 a letter dated June 18, 1973, from Douglas Cram to eight persons enumerated at the top of the letter.

xx

(Plaintiff's Exhibit 27 was marked for identication.)

Q Mr. Cram, did you send that letter to the persons enumerated on Exhibit 27 marked for identification?

A Yes.

MR. LITOWITZ: I offer Exhibit 27 into evidence.

MR. LEE: No objection.

THE COURT: Received.

(Plaintiff's Exhibit 27 for identification was received in evidence.)

xx

Q Mr. Cram, Exhibit 27 reads "Gentlemen: Enclosed is the printer's copy for the final draft" --

THE COURT: Please don't read it. Show it to him. If you have another question about it show it to him and ask him a question.

Q Mr. Cram, looking at Exhibit 27, could you tell us if the final draft of the proxy statement included the suggestions made by the SEC concerning the higher rate paid by American Investors Fund?

A No, it didn't.

Q Is the second sentence in Exhibit 27 therefore untrue?

MR. LEE: Objection.

THE COURT: Sustained as to form.

MR. LEE: I think the exhibit speaks for itself.

Q Mr. Cram, did you discuss with Mr. Frank G. Fowler,

Jr. the comments by the SEC concerning the higher rate of compensation?

A I previously indicated to you that I don't recall a specific conversation indicating my conversation with Mr. Rondeau of the Commission.

We have discussed several times informally before directors' meetings or during the course of the meeting the compensation rates of American Investors Fund.

Q Mr. Cram, the SEC made a specific suggestion in a telephone conversation in the summer of 1973. You testified that you discussed that conversation with both Mr. Lee and Mr. Chestnutt.

I want you, the best you can recall, to tell us the directors you discussed that conversation with, if you discussed it at all.

A As I previously indicated, I have no recollection of discussing that comment. It was not the first time that fees had been discussed.

Q Look back at Exhibit 11, which is your memorandum; I call your attention to --

A My memorandum of June 15th?

Q That's right. I call your attention to paragraph 10. In paragraph 10 you state that the SEC asked you to put in the proxy statement that no higher fee would have been

paid in 1972 than the 1 per cent expense limitation.

You state that you indicated that you would be happy to put in the statement that it was "both true and favorable." Can you explain why it was favorable to have such a statement in the proxy statement?

A It indicates that there would have been no detriment to anyone from the inclusion of that in the contract for the prior year.

Q In the summer of 1973 with the Fund's current level of assets in the then on-going rate of expense, would there have been a rebate due at that current level?

A I don't know that.

Q Looking at Exhibit 15 again, which is the chart which indicates that in May and June the Fund level fell below $150,000,000, does that refresh your recollection as to whether a rebate would be due at that level of fund assets?

A No, it doesn't. It would depend on the computation that was made from time to time and various hypotheses about what would happen to expenses over the remainder of the year, and shareholder account levels, and mailing costs, and postage increases, et cetera, and it was impossible to make that kind of a projection with any kind of accuracy.

Q Will you go to the second page of Exhibit 15 where

expenses are listed for 1972? Exhibit 15 is the chart, the numbers, and looking at the third page, it states the Fund's expenses for the year 1973; does that refresh your recollection as to the level of expenses that was on-going during the summer of 1973?

A I would like you to repeat the question, please, now that I have looked at the chart.

THE COURT: Could you reframe the question?

Q Mr. Cram, were expenses running at more than $400,000 per quarter for the year 1972 and through the first quarter of 1973?

A Here I have the first quarter of 1973 and the expenses are $436,000.

Q And you also have the four quarters for 1972, do you not, as part of that exhibit?

A Yes, I do.

Q And are each of the quarter figures therein excess of $400,000?

A Yes.

Q Does that mean on an annualized rate that expenses would exceed one million six?

A If you make a lot of hypotheses about what the level of net assets are in the number of shareholders' accounts--

Q I am talking now just about the expenses, what they were in 1972 and the first quarter of 1973.

A You mean if you assume everything else in the world stays the same?

Q Just don't regard those other factors. Just concern yourself with the expenses as they were in 1972 and the first quarter of 1973.

THE COURT: Are you asking for the product of the witness' reasoning or are you asking for a mathematical answer? What assumptions is he to make to answer your question.

MR. LITOWITZ: I am trying to ascertain if he understands the rate at which expenses were accruing through '72 and into 1973.

THE COURT: Is it purely a mathematical question?

MR. LITOWTTZ: In part, your Honor, yes.

THE COURT: Well, which is it?

MR. LITOWITZ: It is, your Honor.

THE COURT: Purely mathematical.

MR. LITOWITZ: It is on the exhibit.

THE COURT: If it is on the exhibit then the exhibit speaks for itself. If he is asked to make an assumption based on exhibits told to him at that time or facts later brought to his attention that's a different type of question,

but if you are merely asking him to project a line from an exhibit, the exhibit does speak for itself. It isn't clear to the witness or the court which he is being asked.

Q I will try again. Assuming the expenses stayed or exceeded $400,000 per quarter and further assume that the further net assets stayed at or below $150,000,000; at that level would a rebate be due from the investor to the Fund?

MR. LEE: I object to the form of that question.

THE COURT: Aren't you able to concede that the answer has to be yes? Isn't that purely a matter of mathematics from the exhibit itself?

MR. LEE: No, your Honor, because expenses might go down.

THE COURT: Yes, but the question asked him to assume that the expenses remained the same, and if so, it is a question which may be deduced from the document itself and it is not a proper question it seems to me. Do I misinterpret the documents?

MR. LEE: No.I would say, your Honor, the document on the very first page of it, shows, for example, that on July 31st the assets were 156,000,000; October 31, 174,000,000.

THE COURT: He is only asking about expenses.

MR. LEE: But expenses are directly - for example,

this is prepared in such a way, your Honor, that for every million dollars that the Fund goes up in assets, the advisory fee goes up, and the advice here, in the manner in which my adversary is couching the questions, indicates that he is not distinguishing between out-of-pocket expenses and the advisory fees.

I don't think that your Honor has a copy of this in front of you but I would certainly be happy if your Honor would like to have this while the interrogation is going on.

THE COURT: All right, hand up the copy, but it seems to me that the answer only calls for a mathematical exercise. If that is so, then we ought to go on to something else.

Would you like to reframe the question?

MR. LITOWITZ: I will, your Honor.

Q In the summer of 1973, when you were working on the proxy statement, did you form a judgment as to whether a rebate would be due to the adviser?

A (No response.)

Q Under the 1 per cent expense limitation.

THE COURT: For what period?

MR. LITOWITZ: For the next accounting period of the Fund.

A I formed a judgment, yes.

Q And what was that judgment?

A That it was a possibility although not a probability; not a high probability.

Q In reaching that judgment, did you assume that the Fund would increase its net assets?

A I don't believe so. I believe that had I had to deposit an increase in the Fund's net assets in order to preclude a possibility of a rebate of the funds, of the manager's fee to the Fund, I would not have thought it could be only a possibility. Then it would have been a probability. I think the reason I thought it was merely a possibility that there would be a rebate and not a high probability is because it would have had to have declined from there or the uncontrolled expenses would have had to increase.

Q Did you think expenses would go up or go down when you reached this judgment?

A I think it would have been foolish to assume they would go down when inflation was running at 15 per cent a year.

Q So your assumptions were then that the expenses of the Fund would go up and your assumption was further --

A Everything else being the same, the Fund's expenses would be presumed to go up.

THE COURT: Would you fix a time.

MR. LITOWITZ: The year of 1973. He was working on the proxy statement.

Q So the record is clear that you made an assumption that the Fund's expenses would go up?

A Yes.

Q And the net assets of the Fund would stay about the same?

A No, that's not correct.

MR. LEE: I object.

THE COURT: Overruled.

A If the Fund stayed the same, there would be - I didn't consider it probable that there would be any requirement for the adviser to rebate any portion of his fee to the Fund.

MR. LITOWITZ: Please mark for identification as Exhibit 28 a letter dated July 12, 1973, from Mr. Douglas Cram to the Securities and Exchange Commission.

(Plaintiff's Exhibit 28 was marked for identification.)

xx

Q Mr. Cram, please read Exhibit 28 to yourself (handing).

(Pause.)

MR. LEE: After the witness has read the letter, I would hope the Court would look at the letter before it is

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offered in evidence.

Q Were you the author of Exhibit 28?

A Yes, I was.

MR. LITOWITZ: I offer it in evidence, your Honor.

MR. LEE: No objection.

THE COURT: Received in evidence.

(Plaintiff's Exhibit 28 for identification was received in evidence.)

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Q Mr. Cram, your letter that has been marked as Exhibit 28 has to do with a check that the SEC couldn't locate, is that correct?

A Yes.

Q And then you wrote to the SEC "It showed -- performance."

THE COURT: Don't read it. It is in evidence already with no objection. The court can't understand why you want to read it.

MR. LITOWITZ: I think the relevance of it is that the SEC made comments that were disregarded. I want to know what the witness' attitude was at the SEC.

THE COURT: I will assume that he had a highly negative attitude towards the SEC. I think many people do. I don't think that's very relevant to the issue. Sometimes some days I have such an attitude myself.

Q Did you have a negative attitude about the SEC at the time you wrote this letter?

A Yes.

Q Did you have the same attitude when you were working on the proxy statement in the summer of 1973?

A It depends upon the comment they were making at the time. If I thought they were saying something that was stupid, then I certainly wouldn't hold them in very high estimation for making that stupid comment.

On the other hand, some of the things that they have suggested at times have been highly reasonable. I don't think you will find anybody that practices securities law that thinks everything they do is correct or should be accepted on its face.

Q Do you recognize the name Dr. Bannister?

A Michael C. Bannister, yes.

Q Can you identify him, please?

A I don't really know what his story was but he made a shareholder proposal in '72 or '73 and it was untimely, and I sought to have it excluded from the proxy statement for its untimeliness, and I believe the staff of the Commission indicated that they would take no enforcement action if we deleted it.

Q In drafting proxy statements for American Investors

Fund, were you from time to time looking at proxy statements prepared by other funds?

A Yes, I considered that critical.

MR. LITOWITZ: Please mark for identification as Exhibit 29 a proxy statement of the Keystone Fund, Series S4 dated August 12, 1971.

(Plaintiff's Exhibit 29 was marked for identification.)

xx

Q Mr. Cram, are you familiar with the Keystone Fund?

A Very superficially. I have heard of it. I wouldn't know anything about the adviser ownership of the investor, the type of fund. I am just familiar with the name.

MR. LITOWITZ: I offer into evidence Plaintiff's Exhibit 29.

MR. LEE: No objection.

THE COURT: Received in evidence.

MR. LEE: I fail to see its relevance but I have no objection.

(Plaintiff's Exhibit 29 for identification was received in evidence.)

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THE COURT: This is a proxy statement of some unrelated fund which he has never seen before? Is that right?

MR. LITOWITZ: I haven't asked him if he has ever seen it before, your Honor.

THE COURT: All right, let's get the foundation for it.

Q Have you ever seen this proxy statement, Mr. Cram?

A Not that I recall.

Q Can you look at page 5, please.

A Yes, I am looking at it.

Q The third full paragraph.

A Right.

Q Where a comparison is made with, in this case, the S-4 funds and a generally recognized compilation of fund data which discusses relative rates of compensation and relative expense ratios. Are you familiar with any such studies?

A No, I'm not.

Q In your discussion with the SEC, did you ask if they knew of any studies that bore on the relative rates of compensation or the relative ratios?

A Yes, I did.

Q And did they tell you that none existed?

A No, that isn't the way the conversation occurred. I indicated to the SEC that if they could find us a study we would be willing to consider characterizing our relationship to the facts elicited in that study. The absence of a reply was perhaps erroneous but nevertheless interpreted by me to

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mean that they didn't know of such a study.

Q In the course of your work at Chestnutt Corporation, American Investors Fund, did you become a member of any organization that dealt with mutual funds?

A A member?

Q Or attend meetings of any organization such as the Investment Company Institute?

A I attended meetings of the No-Load Mutual Fund Association which as a matter of fact I assisted in its incorporation as a not-for-profit corporation under the New York Corporation Law.

Q Did that organization ever disseminate information on a comparative basis among different no-load funds?

A No. Let me correct that. No, not to my knowledge.

Q Prior to the summer of 1973 did you ever see any study or publication that dealt with that issue of relative charges paid by mutual funds, no-load or otherwise?

A I have seen it from time to time. I have seen compilations; compilations but no attempt to compute an average or prevailing rate.

MR. LITOWITZ: I have no further questions of Mr. Cram at this time.

THE COURT: Mr. Lee, you may cross-examine.

MR. LEE: Thank you, your Honor.

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CROSS-EXAMINATION

BY MR. LEE:

Q Mr. Cram, I invite you to examine page 4 of Exhibit 29 and I take it the first figure appearing on that page -- Mr. Litowitz, I am sure, will correct me if I am mistaken -- refers to an average market value of this particular fund of 507,000,000; do you see that?

A I see that, yes.

Q Well, if that purports to be the market value, would the size of the Fund have any relationship to its expense ratio based upon what you know about these funds?

A In general there are some economies of scale. A larger fund would be presumed to have a lower expense ratio, which is implicitly recognized by the state security commissioners, which have a maximum permissible expense ratio.

MR. LITOWITZ: I object. It is unresponsive. The answer was not responsive.

THE COURT: I don't know that it is not responsive. I think the answer is all right but the question is somewhat argumentative. I will overrule the objection.

Q Mr. Cram, I show you a document and ask you whether you recognize that document.

THE COURT: Would you mark it for identification.

MR. LEE: Yes. I ask that it be marked Defendant's Exhibit B. It is stipulated.

(Defendant's Exhibit B was marked for identification.)

A Yes, I recognize that memo.

MR. LITOWITZ: May I see it, please?

Q Who prepared it?

A I prepared it.

MR. LITOWITZ: Will you hold it one second, please?

(Pause.)

Q How did you come to prepare that document?

A I believe I prepared it at your request but I can't recall that with certainty.

Q It is dated July 10, 1973. Do you know the occasion for your preparing it?

A I believe that the proxy statement, as a result of the proxy statement and the action sought to be taken there, the same plaintiff--

Q When you say "action" you mean this case?

A This case. No. The action sought to be taken pursuant to the proxy statement, i.e., approval of a new Investment Advisory Agreement with an increased expense ratio limitation, an action was instituted in the United States District Court in Philadelphia --

THE COURT: Are you talking about this action, this particular case?

THE WITNESS: Yes.

A And I believe you asked me to get together some quick information in connection with opposing an attempt to enjoin the meeting. Now that's my recollection.

Q And that information is set forth in Defendant's Exhibit B?

A Yes.

Q Which you prepared?

A Yes, that is what I prepared at that request.

MR. LEE: I offer it in evidence.

Just for the purposes of the record, at this point, your Honor, that was read into the record at the deposition of Mr. Chestnutt in Philadelphia prior to the hearing before Judge Broderick and Judge Broderick quoted from the information, which I will read into the record at this point if I may, just one sentence.

THE COURT: Well, was it prepared from the books and records of one of these corporations?

MR. LEE: Yes. I will ask him.

Q Was this information, Mr. Cram, prepared from the books and records of the American Investors Fund?

A I believe it was prepared from a memorandum which

I got from an accounting officer of the Fund which memorandum itself was prepared from the books and records of the corporation.

MR. LITOWITZ: Your Honor, could I ask the witness a few questions?

THE COURT: If this is based on some other document, that other document must be produced.

MR. LITOWITZ: It is largely based on this document.

VOIR DIRE EXAMINATION

BY MR. LITOWITZ:

Q Was this document circulated to any of the directors of American Investors Fund?

A I would doubt it. It says "Rough Draft" at the top. It was probably hurriedly prepared.

Q It was prepared at Mr. Lee's request for Mr. Lee to use in the injunction action down in Philadelphia?

A That's my recollection.

MR. LITOWITZ: Your Honor, I object to its introduction.

THE COURT: Well, by his own testimony that document was prepared from secondary sources. In the absence of the accounting officer's statement, I think there is no foundation for that document. If it were merely a summary of materials on the borks and records of the American Investors

Fund Incorporated, I would take it, but as I understand it, he based it on another document. In the absence of that other document there is no proper foundation.

BY MR. LEE:

Q With whom did you confer in the preparation of this document?

A I believe it was Mr. Thomas Coco.

Q What was Mr. Coco's position?

A Assistant treasurer of American Investors Fund, as I recall.

Q I show you the last five pages of Defendant's Exhibit B and ask you the source of those five pages.

THE COURT: How does it happen that this document is not recited in the pre-trial order?

MR. LEE: Well, your Honor, it occurred to me that this was the basis for our presentation to Judge Broderick, and I just simply - it was read into the record on Mr. Chesnutt's deposition, and I just simply - it didn't occur to me to introduce it in evidence; that's all. I think it is a superb summary.

THE COURT: That doesn't necessarily make it admissible.

MR. LITOWITZ: Further on this point, I specifically asked Mr. Lee, on Thursday and Friday when I was preparing

the pre-trial order, if he had any exhibits, and he specifically told me he didn't.

MR. LEE: Well, I must say that you didn't advise me of these letters that you introduced this morning. I furnished them to you --

THE COURT: I will not take it without a proper showing because I haven't received the underlying document from which it was prepared.

Is there an open question before the witness?

MR. LEE: Yes. The question is whether he recognizes the last five pages.

A Yes, I recognize them.

Q What are they?

A Well, the first of those pages is the fee schedule of the Bank of New York as transfer agent in effect beginning July 1, 1969.

Q Are you and were you familiar with that in the course of your duties as secretary?

A Yes, I was.

Q What is the next page?

A The next page is a statistical compilation. Well, the next two pages are statistical compilations of charges of the Bank of New York for their services as transfer agent pursuant to the then effective transfer agents' schedule.

Q Was that a record kept in the ordinary course of business of American Investors Fund?

A Yes, it was.

Q What is the next page?

A And the last two pages are similarly identical types of schedules but for different time periods, so the fourth and third to the last pages are the comparative figures for '69 and '70, and the last and second to the last pages are the comparative figures for 1971 and 1972.

MR. LITOWITZ: Your Honor, I will object to the use of anything that precedes 1972 and the time when what we refer to as the old agreement was passed.

THE COURT: Well, I think I might take that for whatever weight it is entitled to here, the expense history.

Has this witness been a secretary of the corporation?

MR. LEE: Yes, your Honor, he was secretary of the corporation and resident counsel.

THE COURT: All right.

Q Was the material contained in Defendant's Exhibit B for identification prepared at your direction and under your supervision and control as a corporate officer?

A Yes, it was. As a matter of fact--

Q All right.

THE COURT: You are talking about the last five pages?

MR. LEE: No, I am talking about the front part of it now.

THE COURT: You can't impeach the man. He already testified that he got some of it from a schedule which an accounting official of the company gave him.

MR. LEE: I am not sure he said a schedule, your Honor. I thought that he was assisted by Mr. Pilco.

THE COURT: I will take the last five pages. I think there is a foundation for that.

THE WITNESS: May I say something?

THE COURT: Don't volunteer, please. Counsel will ask the questions.

Q Mr. Cram, I show you data on page, the second page, commencing investment advisory fee so much, transfer agent fees so much, and other expenses, so much, and ask you the source of that data.

A That data would be contained in the annual report of American Investors Fund which is required by law to be sent to shareholders each year.

Q And is that published data and printed data?

A Yes, it is.

Q And what year does that refer to?

-- I believe it was -- for the year 1967, the first year of the 1 per cent expense ratio limitation.

Q I show you data on the third page and ask you the source of that data.

A The data at the top of the page similarly was from the annual report of the Fund to its shareholders for the year ended December 31, 1972.

The data in the middle of the page was my computation based upon the figures the sources of which I have just given to the court.

THE COURT: Namely what?

THE WITNESS: Namely the annual report of 1967 and 1972. It is merely an arithmetic computation.

MR. LITOWITZ: Your Honor, if I may, I have a copy of this and I have a handwritten note attached to certain of these pages which contains a caveat.

MR. LEE: It is attached.

THE COURT: You may call the caveat to his attention by way of voir dire if Mr. Lee is --

MR. LEE: In other words, Mr. Litowitz has a copy of the document to which I am referring.

THE COURT: Are you offering it including the handwritten note?

MR. LEE: Yes.

THE COURT: Do you need voir dire examination or not?

MR. LITOWITZ: Yes, I do, your Honor. I think the caveat indicates that the numbers being referred to may not be accurate.

THE COURT: You can ask him if you wish. That would go to the weight of the document, wouldn't it, not its admissibility?

MR. LEE: I don't think it refers to accuracy at all. It refers to the qualification. I would like for the witness to read the caveat into the record.

THE COURT: No, Mr. Litowitz may examine in the nature of a voir dire. He may call the witness' attention to the caveat if it is not clear what it means on its face.

MR. LEE: Would you like to examine right now, Mr. Litowitz?

MR. LITOWITZ: Yes.

BY MR. LITOWITZ:

Q Mr. Cram, are you looking at the caveat?

A Yes, I am.

Q Does that indicate that certain adjustments have to be made to the numbers contained in the pages prior to the caveat?

A No. The numbers are what they purport to be.

Q What is the adjustment referred to?

A What I am saying there is that I drew a conclusion as to what happened to transfer agent fees, all right? Now the transfer agent fees went up for two reasons: increase in the number of shareholder accounts and increase in what is charged per account. But when you give the wrong number you don't want to go back and say "The transfer agent fee schedule increased by 100 per cent." You want to say"The transfer agent charges increased by 100 per cent." And then further computations would be necessary to segregate which portion of the increase was the result of higher fee schedules and which portion of the increase was responsible, was originated by increased number of shareholder accounts.

Nevertheless, the conclusion, whatever it was, 100 per cent increase in transfer agent charges, I stand by that number. 127 per cent.

Similarly with postage. Postage went up from five cents to eight cents or maybe to ten cents even by that time, but the charges also went up because we had more shareholders to whom we were obliged to send material.. That's what the caveat means.

MR. LITOWITZ: Your Honor, I still press the objection.

THE COURT: Objection overruled. It may be received

in evidence.

(Defendant's Exhibit B for identification was received in evidence.)

THE COURT: Mr. Lee, you may continue.

MR. LEE: Your Honor, I would hope that you can read at this point the concluding paragraph.

THE COURT: You go ahead and complete the examination.

BY MR. LEE:

Q As a result of the tabulation that you prepared, Mr. Cram, during the five-year period 1967 through 1972, what was the increase in the expenses of the Fund without regard to any advisory fee whatever?

MR. LITOWITZ: I object, your Honor.

THE COURT: Is this something where the exhibit speaks for itself?

MR. LEE: Yes, your Honor, but I just wanted to tie it in.

THE COURT: It isn't necessary. You will be permitted to file a post-trial memorandum on that score. The exhibit speaks for itself and I will take it.

MR. LEE: May I just ask this one question:

Q Is the data contained in the penultimate paragraph of your memorandum identical to the data contained in Judge Broderick's opinion in Philadelphia?

MR. LITOWITZ: I object, your Honor.

THE COURT: Well, it speaks for itself, doesn't it?

MR. LEE: Yes, but simply for clarity on the record, your Honor.

THE COURT: Very well.

A I believe so; yes.

MR. LEE: No further questions.

THE COURT: Any redirect examination?

MR. LITOWITZ: Yes, your Honor.

REDIRECT EXAMINATION

BY MR. LITOWITZ:

Q Mr. Cram, do you have before you Exhibit 15?

A Yes, I do.

Q From your recollection, do you recall the net assets of the Fund in the summer or fall of 1972?

A Without refreshing my recollection, you mean?

Q Without looking at any of the documents.

A No.

Q Looking at Exhibit 15, does that help your recollection?

A We are talking about the fall of '72?

Q Or the summer of '72.

A That's 73.

(Pause.)

Q If I may, let me show you Exhibit 24.

A I don't see it here.

Q If I may, let me show you Exhibit 24 which has a table showing the per share asset value and also the total dated as at June 30, 1974, and I ask you if that refreshes your recollection as to how the net asset value of the fund declined from the summer of 1972 to the summer of 1973.

MR. LEE: Are you talking about the summer?

MR. LITOWITZ: Yes.

A They only have year end here.

Q Does that refresh your recollection as to what happened to the Fund's assets?

A No. The fluctuations were enormous during those years. They continue to be enormous. Year end doesn't help me very much.

MR. LITOWITZ: I have no further questions.

THE COURT: Anything else for this witness?

MR. LEE: No, your Honor.

THE COURT: All right, you may be excused.

(Witness excused.)

THE COURT: We will take a short recess now and I would like to ask you during the recess to do two things. Please give the clerk the exhibits which have been received so may

be marked. And if either of you have any documents which you do not have listed on the pre-trial order which you intend to use I would suggest you disclose them so that we can expedite our trial. Show them to each other.

All right, we will be in recess.

(Recess.)

(Plaintiff's Exhibits 1 through 10, 12, 13, 14B and C, 16 through 26 and 30 through 36 were received in evidence.)

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THE COURT: All right, call the next witness, please.

MR. LITOWITZ: Mr. Greene, please.

W A R R E N K. G R E E N E, called as a witness, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LITOWITZ:

Q State your home address.

A 249 Overlook Drive, Greenwich, Connecticut.

Q In the summer of 1973 were you a director of the American Investors Fund?

A Yes.

Q When did you become a director of American Investors Fund?

A 1966.

Q During the summer of 1973 were you also a director of Chestnutt Corporation?

A Yes.

Q When did you become a director of Chestnutt Corporation?

A I believe it was in 1967.

Q Are you presently a shareholder of Chestnutt Corporation?

A Yes.

Q When did you first become a shareholder of Chestnutt Corporation?

A Around 1967.

Q Have you remained a shareholder of Chestnutt Corporation continuously from 1967 to the present?

A Yes.

Q Did you attend a meeting of American Investors Fund directors on May 21, 1973, at which time the advisory contract between Chestnutt Corporation and American Investors Fund was discussed?

A Yes.

Q Prior to that time, did you receive, as a director of American Investors Fund, any literature pertaining to the 1 per cent expense limitation in the agreement between Chestnutt and American?

THE COURT: By literature I assume you mean any document?

MR. LITOWITZ: That's right.

A No.

Q Did you attend a meeting of American Investors Fund on June 5, 1973, at which time the board approved the new contract with a 1-1/2 per cent expense limitation?

A Yes.

Q Between the period May 21, 1972, and June 5, 1973, did you receive any document from anyone respecting the change in expense limitation?

A Not that I can recall.

Q To the best of your knowledge, prior to June 5, 1973, was any document prepared by anyone and circulated to fund directors respecting the 1 per cent limitation?

A No.

Q To your knowledge was any such document prepared but not circulated to fund directors?

A None was prepared to my knowledge.

Q Now is it correct that you voted as a director of American Investors Fund to increase the expense limitation from 1 per cent to 1-1/2 per cent?

A That's correct.

Q Could you tell us the factors that caused you to

vote for the increase?

A Yes.

Q Would you enumerate them, please?

A The main factor was that the tight 1 per cent limitation could put Chestnutt Corporation in the position of underwriting future expenses for the Fund to the financial detriment of Chestnutt Corporation.

Q By that do you mean that there was a chance that Chestnutt Corporation would have to make a rebate to the Fund under the 1 per cent limitation under the agreement?

A No. By that I mean that if you had taken the worst case situation whereby a very drastic decrease in the net asset value of American Investors Fund shares or net asset value of American Investors Fund would go down to a substantial extent, it would, in my view, jeopardize the ability of the investment adviser to function.

Q I show you Exhibit 4, which is the Advisory Agreement in effect between Chestnutt and American Investors that was in effect in the summer of 1973 and I ask you if you understood when this would have expired by its own terms.

THE COURT: Are you asking him for his present understanding or his understanding in the summer of '73?

Q Your understanding of that in the summer of 1973.

A It had an expiration date on it which would have

expired in about another year.

Q And Exhibit 4 is the agreement under which Chestnutt Corporation operated with American Investors Fund, is that correct?

A That's correct.

Q And with a year to go a vote was taken to increase the expense limitation, is that correct?

A That's correct.

THE COURT: When did that agreement expire, just for the record?

MR. LITOWITZ: Your Honor, by its terms it expires the day before September 1, 1974, but the provision of the agreement is such that the fee is payable for the full quarter prior so the effective rate of compensation under this agreement would have started July 1, 1972, and it would have continued for eight successive quarters.

THE COURT: Do you agree with that?

MR. LEE: I am lost at one thing he said. I think that it is a contract and it speaks for itself.

THE COURT: Perhaps it does, but you see this issue has been a source of confusion for the court in various pre-trial discussions that we have had, and I would like to get your respective contentions clear in my mind.

As I understand it the plaintiff contends that the

agreement by its terms expires August 31st but then I didn't quite absorb the meaning of the exception.

MR. LEE: The agreement by its terms, your Honor, was to have expired June 30, 1974.

THE COURT: All right. It is a matter of dispute then. You may continue the examination.

Q Mr. Greene, can you tell us what events occurred between the time of September 1, 1972, when Exhibit 4 went into effect and May and June, 1973, when you voted on increasing the expense limitation?

A Could you give me an idea of what kind of events you are talking about?

Q Events that caused you to vote to increase the expense limitation.

A I already gave you my reason for my - my primary reason for -

THE COURT: He is asking you whether any changes in circumstance took place between the date of the agreement you are holding in your hand, Exhibit 4, and the occasion during the summer of 1973 when you concluded that things changed.

A There were no events.

THE COURT: Didn't the market go down?

THE WITNESS: I can't tell, sir, from the exact

points here, without refreshing my memory.

THE COURT: All right.

Q Mr. Greene, I show you Exhibit 15 andask you if this refreshes your recollection respecting what happened to the net assets of the Fund during the period when the old agreement was in effect or put into effect and the summer of 1973 when the expense limitation was changed?

A This indicates on June 30th the Fund's assets were approximately 146,000,000.

THE COURT: Of what year?

THE WITNESS: 1973.

Q And does it further indicate that on January 2nd of 1973 the Fund's assets were over $210,000,000?

A That's correct.

Q Do you recall whether in September of 1972 the assets were higher than $210,000,000?

A On which date?

Q September, 1972.

A Judging from this January 2nd figure, 1973, I would assume that they were higher.

Q Now, was the drop in the net asset value of the Fund one of the factors that you considered in voting to change the expense limitation?

A There is no question in my mind that the fact

that the fund had dropped down was going to and had been putting pressure on that 1 per cent limitation in as much as other expenses that we had no control over were rising; yes.

Q In the summer of 1973 did you form an opinion as to whether a rebate would be due if the 1 per cent limitation stayed in effect?

A In my opinion at the time it was that no rebate would be due.

MR. LITOWITZ: I have no further questions, your Honor

THE COURT: Any cross-examination?

MR. LEE: Do I understand that Mr. Litowitz has put into evidence the entire deposition of Mr. Greene?

MR. LITOWITZ: Yes.

MR. LEE: So that we may deem the entire deposition in evidence?

THE COURT: Yes.

CROSS-EXAMINATION

BY MR. LEE:

Q Mr. Greene, I show you Exhibit 14A and B and ask you when was the first time you saw that exhibt?

MR. LITOWITZ: Excuse me. If I may just note for the record so that it is clear, Exhibit 14A was a document that existed prior to the litigation.

Exhibit 14B was typed by Mr. Lee. It was just typed

so it could be used by the parties to this litigation. Is that correct, Mr. Lee?

MR. LEE: That's correct.

THE COURT: All right.

A I saw this document on the occasion of our directors' meeting.

THE COURT: Are you talking about 14A now?

THE WITNESS: 14A.

Q On what date?

A June 5, 1973.

Q Who prepared that document?

A Mr. Eugene Ulrich.

Q And Mr. Ulrich is a director?

A Yes.

Q Now, can you tell us what that document represents?

MR. LITOWITZ: I object, your Honor. The document speaks for itself.

THE COURT: Well, does it? Hand it to the court.

(Pause.)

THE COURT: As to 14A, I will permit the witness to answer.

A It is a listing of no-load mutual funds which had assets over $100,000,000, and it has in columnar form the number of shareholders in each fund; another column is

entitled "Turnover"; and another column has expenses as a per cent of assets, and there is one other column which is a fee schedule for each of these funds.

Q Now, at the time that you saw that at the directors' meeting, what was it, if anything, that you considered significant about that figure?

A It is significant that American Investors Fund has a largernumber of shareholders in relationship to net assets than the other funds listed on this page.

Q In the course of your work as a director of American Investors Fund and of Chestnutt Corporation, have you ever determined what the cost of a particular stockholder accounts is on the books of the Fund?

A The cost is approximately $6.

THE COURT: Per year?

THE WITNESS: Per year, sir.

Q That is for each shareholder?

A Yes.

THE COURT: That includes the adviser, does it?

THE WITNESS: No, sir. Those costs include the Bank of New York charges for transfer agency work, mailing expenses, printing expenses, postage, et cetera.

Q What is the largest of the no-load funds, Mr. Greene?

A T. Rowe Price, a common stock fund.

THE COURT: You are talking as of '73, mid-summer?

MR. LEE: I will define it.

Q Was that so in mid-summer of 1973?

A I believe so.

Q And approximately what were the assets? Would you like to look at this exhibit? What were the assets of T. Rowe Price at the time?

THE COURT: If it is all on the exhibit, I will take it. You don't need to go through that.

MR. LEE: Very well.

Q During your experience as a director, Mr. Greene, has the Board of directors of the Fund given any consideration to the matter of the small shareholder accounts?

A Yes.

Q And what has been done in that regard while you have been a director?

A The first action taken was to raise the minimum amount that a new investment could start an account with the Fund.

Q And when was that taken?

A I don't recall the exact year. I believe it was in 1970.

Q What was that minimum?

A There was no previous minimum. An investment could

start by buying $10 worth of the Fund's shares, or any amount, but as a result we were collecting many, many very small accounts which were not economical in relationship to the costs of carrying those accounts.

As a remedy, we instituted the $400 minimum.

Q Are you familiar with the general practice in the investment company industry as to account minima?

THE COURT: Is that relevant to this case? We have to take it the way we find it, don't we? All parties to this litigation have to take the situation the way it stood.

MR. LEE: Very well.

THE COURT: I will permit you to make an offer of proof with respect to it if you need it to complete your record.

MR. LEE: No, I don't believe it is necessary. It was just information for the Court.

Q Did the Fund take any other steps in connection with the small shareholder accounts?

A Yes. The Fund also was concerned with the number of accounts which had less than five shares.

These very small accounts resulted sometimes from people buying a large amount and then redeeming and leaving a rather small balance, so at one point down the

line the Board authorized the redemption of these very small accounts and the shareholders were sent a check for their balance.

Q And when was that?

A I don't recall the exact year. I think it was 1972 but I'm not sure.

Q Has the Fund taken any other steps in that connection?

A Yes. Last year we proposed that shareholders who held 50 shares or less - rather, those who held less than 50 shares build up their account to above that amount or they would be redeemed and sent proceeds for that amount.

Q During the period 1970 through 1973, and specifically June 5, 1973, the date of the directors' meeting, has the question of expenses and shareholder account size been discussed at directors' meetings?

A Yes.

MR. LEE: No further questions.

THE COURT: Anything else of this witness?

MR. LITOWITZ: Yes, your Honor.

REDIRECT EXAMINATION

BY MR. LITOWITZ:

Q Mr. Greene, I believe you testified that American Investors Fund had a larger number of shareholders in relation

to its net assets than the other funds indicated on 14A, Exhibit 14A, is that correct?

A That's correct.

Q Now, is that something that only happened after the summer of 1972?

A No. I think it was - that relationship existed for some time because we didn't have a minimum investment.

Q So then if that situation did exist under the old Advisory Agreement it was voted on in the summer of 1972, is that correct?

A Yes.

Q You indicated, I believe, that it cost about $6 to maintain an account?

A Yes.

Q At what time was this study made that indicated it cost $6 per account?

A It's been my understanding at least for the last two years, perhaps even longer, that that was the average cost per account.

Q Did the price of maintaining an account increase dramatically from the summer of 1972 to the summer of 1973?

THE COURT: '73?

MR. LINOWITZ: Yes.

A I don't think it increased dramatically but there

might have been some increased costs from the Bank of New York for handling. Certainly the postage alone was a substantial increase. You see, that would include - that postage would be included in the $5 charge and that, I believe, did increase in that period.

Q You indicated that in about 1970 an attempt was made to raise the minimum amount of investment?

A We proposed that those shareholders would have to have at least five shares or more.

Q I'm sorry. I thought there was a discussion of a $400 minimum.

A That's right. That was in 1970.

Q Can you explain to us why that was done in 1970?

A Yes. As I mentioned before, we were picking up many, many small accounts that couldn't pay or couldn't be economical.

For example, if someone invested a hundred dollars into the fund and the average costs, excluding the management fees, were approximately $6, that would mean that our expense ratio on that particular portion of the assets would be 6 per cent, so we wanted to get it up to where we could accept new accounts without having too much effect on the expense ratio limitations.

Q And the directors were aware of this problem in

1970, is that correct?

A Yes.

Q Were they aware of this problem in 1972 when they put into effect the agreement of the 1 per cent expense limitation?

A I was aware of it.

MR. LEE: That's a misstatement that expense limitation since 1967.

THE COURT: Well, wasn't it 1972?

MR. LEE: There was a new agreement in '72. There has been a new agreement every year.

THE COURT: When the 1972 agreement was passed, of course they were aware of it, isn't that so?

THE WITNESS: Yes.

MR. LITOWITZ: I have no further questions, your Honor.

THE COURT: Anything else?

RECROSS EXAMINATION

BY MR. LEE:

Q Mr. Greene, during the time you have been a director of the Fund, how often has a new Investment Advisory Agreement been entered into?

A Each year.

Q And what has been the term in years of each

Investment Advisory Agreement?

A Two.

Q So that in each year since you have been a director of the fund the Investment Advisory Agreement has been renewed each year although it had one year to run, is that correct?

A That's correct.

Q So that it was changed or a new agreement was adopted with a new expiration date one year prior to the expiration of the old one?

A That's correct.

MR. LEE: No further questions.

THE COURT: Anything else of this witness?

MR. LITOWITZ: No, your Honor.

THE COURT: All right. You are excused.

(Witness excused.)

MR. LITOWITZ: I will call Mr. George Chestnutt.

G E O R G E A. C H E S T N U T T, called as a witness, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LITOWITZ:

Q State your residence address, please, Mr. Chestnutt.

A 944 Lake Avenue, Greenwich, Connecticut.

Q Are you a shareholder of Chestnutt Corporation?

A Yes.

Q And were you a shareholder of Chestnutt Corporation in the summer of 1973?

A Yes.

Q At that time what percentage of the outstanding shares of Chestnutt Corporation did you own?

A Approximately 47 per cent.

Q Do you recall what you were receiving as compensation from the Chestnutt Corporation during the year 1973?

MR. LEE: I object to this, your Honor, as being --

THE COURT: Sustained unless it doesn't appear in the annual statements. I don't see how it is relevant whether he was receiving a million dollars.

MR. LITOWITZ: It doesn't appear in the statements.

THE COURT: I will sustain the objection unless you can give me a showing. I assume the man was getting a salary from the company and was making some money for his time and effort. I don't think it is relevant how much.

MR. LITOWITZ: I think the amount is relevant, your Honor. An issue might be whether the adviser was in a position to carry on or if they were going to have to make a separate.

THE COURT: I don't know that that issue is being

tendered to me here.

Is it, Mr. Lee?

MR. LEE: If I understood him to say as to whether the adviser could carry on or be rendered insolvent, I don't think there was the threat of imminent insolvency; no.

THE COURT: Don't lets qualify it by the use of the word "imminent."

Are you contending or do you intend to contend that if they had not continued at the old rate, the Chestnutt Company would have been rendered insolvent?

MR. LEE: We do not contend that it would be rendered insolvent.

THE COURT: Or would have been prevented from performance by lack of money?

MR. LEE: It could have had its performance impaired considerably.

THE COURT: I will have to withdraw my ruling. Objection overruled.

Q Would you state the compensation you were receiving from Chestnutt Corporation in the summer of 1973?

A Well, of the order of about $79,000.

Q And do you recall the approximate amount of compensation you were receiving from Chestnutt Corporation in 1972?

A I think it was about the same.

Q In the years prior to 1972, and possibly for the three years preceding, was your compensation from Chestnutt Corporation higher than $79,000?

A The highest salary rate that I ever reached was 135,000 annual rate but it was not sustained for the entire year; it was for only a few months and then it dropped sharply back down and I might point out that of that amount a substantial amount was reinvested in shares of the company so that money didn't deplete the assets of the company but went right back into additional shares of the company.

Q Do you recall approximately when that point was when you reached the 130,000-plus salary rate?

A I think it would be in 1968 or 1969.

Q And from that period down to 1972 was it more or less a gradual diminution from 130,000 down toward the $80,000 rate?

A Fairly sharp. I wouldn't call it gradual. It didn't seem gradual to me.

Q Did it ever go below the $80,000 level prior to 1972?

A Yes.

Q And at what point was that?

A I'm sorry but I said yes before you said prior to

1972. So I mean my mind was not right with you.

I think it was after 1972 that it dropped below that.

Q So your salary ranged from 130,000 in about 1968 down to 19, in the period 1972 to 80,000 or below, is that correct? It never fell below 80,000 prior to 1972?

A I think that - if you want the exact facts they are obtainable. You are asking me to recall something that I am not quite certain of and I think if it really means anything we should find out precisely how much salary I got each year and put it in the record, and I must confess that my recollection of exactly how much salary I got each of those years is not very fresh.

MR. LITOWITZ: Will you stipulate it?

MR. LEE: We will so stipulate.

THE COURT: What are you stipulating?

MR. LEE: We will stipulate that Mr. Chestnutt's salary and income from Chestnutt Corporation for the years that Mr. Litowitz wants.

MR. LITOWITZ: Will you provide that for us and read it into the record tomorrow?

MR. LEE: I don't know whether I can get that that quickly but I will try.

THE COURT: All right.

Q Did there come a time when Chestnutt Corporation

invested in Cascade Airways?

A Yes.

Q When, approximately, was that?

THE COURT: I wonder if we are getting a little far afield here. I take it Chestnutt Corporation is not a publicly held company and it belongs to this witness and other persons? Unless there is a claim of insolvency on the part of Chestnutt Corporation I don't intend to try its internal financial affairs. It looks to me as if he was making at least $80,000 most years during this period so if he can draw that kind of salary the company was not insolvent or threatened with insolvency.

MR. LITOWITZ: That's the point of this. I have two slight offers. One was an investment in Cascade Airline and the other is an investment in a building.

THE COURT: Can't we have a stipulation as to the net worth of the Chestnutt Corporation?

MR. LEE: The financial statements are in evidence, your Honor.

THE COURT: Of Chestnutt Corporation?

MR. LEE: Yes. I furnished them to Mr. Litowitz months ago.

THE COURT: Hand them in.

MR. LITOWITZ: There is a statement of net worth.

It is in the record already.

THE COURT: Pass the record to the clerk if it is an exhibit.

MR. LITOWITZ: I think it is Exhibit 16.

THE COURT: Please understand, I don't have any exhibits before me up here on the bench except for 29 and 25.

MR. LITOWITZ: Your Honor, Exhibit 16 is the full year statement for the year preceding the change in expense limitations.

THE COURT: All right. Certainly the exhibit justifies the conclusion of solvency, doesn't it?

MR. LITOWITZ: Your Honor, I would contend that the company is very solvent.

THE COURT: You don't dispute that?

MR. LEE: The company has lost money in the calendar year '74.

THE COURT: But in '72 --

MR. LEE: Its balance sheet shows a considerable net worth, and --

THE COURT: '73 is substantially the same net worth?

MR. LEE: 73?

THE COURT: Yes.

MR. LEE: Yes.

THE COURT: I have '72.

MR. LEE: '72 is substantial in its net worth, yes.

THE COURT: All right. Let's go on to something else.

Q Does Chestnutt Corporation own the building in which it operates?

A Yes.

Q Approximately how large a building is that?

A 11,700 square feet of usable space.

Q And approximately what percentage of that is used by Chestnutt Corporation?

A All of it.

THE COURT: Where is this office?

THE WITNESS: Greenwich, Connecticut.

Q Was that building built by Chestnutt Corporation?

A Yes.

Q When was it built?

A In 1965, finished in 1966 for the major part of it, one floor in back was added the following year.

Q And on how much land is that building set?

THE COURT: No more about the building. I am prepared to find that the Chestnutt Corporation had a net worth of approximately $3,000,000 as per its books during the relevant period. If they come forward with any proof to the contrary, I will permit you to reopen the question.

MR. LITOWITZ: I have no further questions of this witness, your Honor.

MR. LEE: Just for purposes of cross-examination now, and I will call Mr. Chestnutt subsequently but, Mr. Chestnutt, I will limit myself to cross-examination.

CROSS-EXAMINATION

BY MR. LEE:

Q What is the largest number of employees that Chestnutt Corporation has had to the best of your recollection?

A Approximately 110.

Q At the end of 1974 what was the total number of employees?

A Approximately 37.

Q When Mr. Cram left Chestnutt Corporation in September, 1973, to go to Pepsico, were you informed whether he left, whether he received a larger salary at Pepsico than he got from Pepsico Corporation?

A Yes, I was.

MR. LITOWITZ: I object.

THE COURT: I don't see the relevance. Mr. Cram was here and he could have been cross-examined as to his motivation in leaving.

MR. LEE: Very well.

THE COURT: I will let you complete your record. What is the answer?

MR. LEE: Well, he answered that he was informed that he got a higher salary.

THE COURT: At Pepsico.

MR. LEE: At Pepsico, yes.

No.further questions on cross.

THE COURT: You may step down.

(Witness excused.)

MR. LITOWITZ: I will call Mr. Frank Fowler to the stand, please.

F R A N K G. F O W L E R, called as a witness, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LITOWITZ:

Q State your home address, please.

A South Salem, New York.

Q Mr. Fowler, can you tell us the circumstances under which you became a director of American Investors Fund?

A One of the directors, Mr. Sabel, is a neighbor of mine -- was, he isn't now -- and he asked me if I would be interested in becoming a member. And I said yes, that I would.

Q Can you tell us what happened next?

A Well, I was introduced to Mr. Chestnutt, and shortly thereafter I was elected a member of the board.

Q Prior to being asked by Mr. Sabel, had you ever served as a director of a public corporation?

A No.

Q To this date, have you ever served as a director of a public corporation?

A No.

Q Did Mr. Sabel discuss with you what your duties were as a director of American Investors Fund and what those duties would be?

A Oh, I'm sure he did.

Q And to the best of your recollection, what did he explain to you about what your duties were?

A Well, it is rather broad a question, I think. Can you be more specific?

Q Well, let me approach it a different way.

After becoming a director, did you read anything, or try to somehow ascertain how you were to function as a director of American Investors Fund?

A Yes.

Q Can you tell us what you read or what you did to learn about your job as a director?

A Well, I read all the prospectuses and proxy statements, also some manuals on such things as investment services.

Q Did you ever read a study known as the Wharton Report?

A The Wharton Report?

Q Yes.

A No.

Q By that I am referring to the Wharton School of Finance and Commerce, a study of mutual funds issued in 1962. Did you ever hear of the Wharton Report?

A I have heard of the Wharton Business School but I never saw that report.

Q Did you ever read the SEC report on the public policies economics of investment company growth issued in 1966 by the SEC?

A I don't recall.

Q Did you ever hear of such a report?

A Would you mind stating that again?

THE COURT: He says he didn't read it. Whether he heard of it or not is irrelevant. Let's go on to something else.

Q Do you know what law governs the American Investors Fund?

A Well, of course, the SEC has great control over it.

Q Is there a particular statute under which American Investors Fund operates, to your knowledge?

A Well, our charter and so forth is approved by the SEC.

Q Have you ever heard of the Investment Company Act of 1940?

A I have.

Q Do you know whether the American Investors Fund has filed with the SEC pursuant to that Act?

A I don't recall that.

Q Did you ever read the Investment Company Amendments Act of 1970?

A I don't recall having done that.

Q Are you generally aware of the fact that in 1970 some amendments were made to the Investment Company Act?

A I'm sure they were brought to our attention, as a member of the board.

Q Are you a director of Chestnutt Corporation?

A No.

Q Do you know which of the present American Investors Fund directors are directors of Chestnutt Corporation?

A I believe so.

Q Can you state who those persons are?

A On the board of Chestnutt Corporation?

Q Yes.

A Mr. Greene, John Currier, Mr. Lee, of course Mr. Chestnutt.

Q Do you know which American Investors Fund directors are shareholders of Chestnutt Corporation at the present time?

A Well, the ones that I have just mentioned are shareholders of American Investors Fund.

Q Are they also shareholders of Chestnut Corporation?

A No, not all of them.

Q Do you know which of the American Investors Fund directors are shareholders of Chestnutt Corporation?

A That would be Mr. Currier, Mr. Lee, and of course Mr. Greene and Mr. Chestnutt.

Q Now back in the summer of 1973 when you were voting on increasing the expense limitation, did you know at that time which of the American Investors Fund directors were also directors of Chestnutt Corporation?

A I did.

Q And who were the directors at that time of American Investors Fund that were also directors of Chestnutt Corporation?

A Mr. Greene, Mr. Chestnutt and John Currier, and I guess Mr. Sabel.

Q At that same time in 1973 did you know which of the American Investors Fund directors were shareholders of Chestnutt Corporation?

A Excuse me? Isn't that the same question?

Q No, the other related to who were directors of both American Investors Fund and Chestnutt Corporation. Now I am asking you which of the directors of American Investors Fund were also shareholders of Chestnutt Corporation?

A Well, it would be Mr. Chestnutt, Mr. Greene and Mr. Sabel and Mr. Currier.

Q Now those four gentlemen, were they shareholders or directors or both in the summer of 1973?

A I think they were both.

Q Can you explain how the current rate of compensation is paid by American Investors Fund to Chestnutt Corporation?

A Yes. It is on a sliding scale on the first million they get 6/10 of 1 per cent, on the second 50,000,000 they get 6/10 of 1 per cent and then I think it goes down to 4/10 for anything over a hundred million dollars.

Q In the summer of 1973 did you understand how the expense limitation worked?

A Yes.

Q Can you explain how that worked?

A Well, that would be the expense of administering

the Fund by the adviser, and of course at that time things were going up terribly so while it was at that time 1 per cent -- in other words, there was only really 2/10 of 1 per cent really for operating or for expenses of the Fund which is mighty small.

Q Did the expense limitation work in such a manner that Chestnutt Corporation could be called upon to make a rebate to the Fund?

A Would you ask that question again, please?

MR. LITOWITZ: Could you read the question, please?

THE COURT: No. Frame it again.

As I understand it, you are not a lawyer.

THE WITNESS: No, sir, I'm not a lawyer.

THE COURT: Reframe the question.

Q Did you understand that if the expenses of the Fund got too high that Chestnutt Corporation would have to give some of its fee back to the Fund?

A Oh, yes.

Q And at what point in 1973, under the old agreement that was in effect, at what point would that rebate come?

A At the end of the year.

Q And how were the calculations made? What would be the two variables that would be considered?

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MR. LEE: I object.

THE COURT: Sustained as to form.

Q Did you understand the components that must be looked at in computing a rebate under the 1 per cent expense limitation?

MR. LEE: Objection.

THE COURT: He can answer it yes or no. As I understand it, this witness is an engineer, a consultant to municipalities, and if his expertise runs in that direction, he may answer the question.

Objection overruled. You may answer the question.

A You asked me if I was familiar with --

MR. LITOWITZ: Would you read the question, please?

THE COURT: No more reading of the question. Frame a new question.

Q Could you explain the components that must be examined to compute the rebate under the 1 per cent expense limitation?

A Yes.

Q And what were the components?

A Well, it is based entirely on the number of shareholders we have, our gross assets, and our expenses.

Q In the summer of 1973 did you believe that Chestnutt

Corporation charged a higher fee to American Investors Fund than most other advisers charged most other no-load funds?

A No.

Q In the summer of 1973 did anyone discuss with you that the SEC wanted a statement to that effect in the proxy statement?

A I don't recall it.

MR. LITOWITZ: I have no further questions at this time.

THE COURT: Anything else from Mr. Fowler?

CROSS-EXAMINATION

BY MR. LEE:

Q Mr. Fowler, is Mr. Sabel a director of Chestnutt Corporation?

A I believe he is.

Q Is Mr. Chestnutt a director of Chestnutt Corporation?

A Yes, sir.

Q And Mr. Greene, is he a director of Chestnutt Corporation?

A Yes.

Q And is Clendon Lee a director of Chestnutt Corporation?

A Yes.

Q I understood you to say, I believe, but I'm not certain, did you say that Mr. Currier was a director of Chestnutt Corporation?

A It is possible I did.

MR. LITOWITZ: I object, your Honor.

THE COURT: He was just asked his best knowledge as to whether he was a director or not. As I understand it, this witness is not a director of Chestnutt, is that correct?

THE WITNESS: That's correct. Not at all.

MR. LEE: I just want to be sure what his testimony is.

THE COURT: His testimony was that Mr. Currier was but that may not be the best evidence of whether Mr. Currier is or not. It is just his understanding.

Q Is that your understanding, Mr. Fowler?

MR. LITOWITZ: I object, your Honor.

THE COURT: He can say whether that is his understanding.

A That he is a director?

Q Yes.

A I believe he is not a director.

THE COURT: Didn't you just tell us that he was?

THE WITNESS: I thought he was but I am just trying to-

MR. LEE: No further questions.

THE COURT: Anything else?

MR. LITOWITZ: I have nothing further.

THE COURT: All right, you may step down.

(Witness excused.)

MR. LITOWITZ: Your Honor, the plaintiff has no further evidence at this time.

THE COURT: All right, the plaintiff rests.

MR. LEE: First I call Mr. Eugene Ulrich.

E U G E N E A. U L R I C H, called as a witness, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LEE:

Q Mr. Ulrich, what is your occupation?

A Right now I'm financial vice president of the Bato Company, Inc.

Q And what is the Bato Corporation?

A We are manufacturers and distributors of newsprint.

Q Would you outline briefly your educational background?

A Graduate of Dartmouth College, Master's in business administration from the Amos Tuck School, and a CPA.

Q Would you outline briefly your business experience?

A After being in the Navy I had 11 years with Arthur Anderson & Company at which point I was a manager.

I then joined Sinclair as director of internal audit.

THE COURT: Sinclair Oil Company?

THE WITNESS: Yes, sir.

A On the merger of Sinclair I became the comptroller of the BP Oil Corporation.

Q That is British Petroleum, is that correct?

A British Petroleum is a parent of the BP Oil Corporation.

On leaving BP I became assistant comptroller of American Airlines, in June of 1974 I joined the Bato Company.

Q In the course of your work with Arthur Anderson Company did you become familiar with regulated investment companies?

A Yes, sir.

Q What was the nature of that familiarity?

A I was auditing manager on several regulated investment companies including National Investments, Pine Street Fund, and all of the captive funds, U.S. Funds of IOS.

Q IOS being the Swiss enterprise?

A Yes.

Q Were you ever engaged in the audit of the Swiss

corporations?

A No, sir. The funds that I audited were individual funds that were set up and registered under the SEC Act and where fully legal from all United States standpoints of the law to the best of my knowledge.

Q I take it that your work for the IOS domestic fund has not been called into question so far as you know?

A That's right.

Q In the course of your work with investment companies did you become familiar with the expenses of investment companies and the conduct of their affairs?

A Yes, sir.

Q Approximately how long were you engaged in working on the audit of regulated investment companies?

A It must have been over a period of five or six years.

Q Are you familiar with the forms filed by investment companies with the SEC?

A Yes, I am.

Q Are you familiar with their proxy statements?

A Yes.

Q Are you familiar with their prospectuses?

A Yes.

Q Are you familiar with their annual reports?

A Yes.

Q And the Form N1R report..?

A Yes.

Q When did you become a director of American Investors Fund?

A In May of 1971, I believe.

Q At the time you became a director of American Investors Funds were you familiar with its past practice in connection with Investment Advisory Agreements?

MR. LITOWITZ: I object. Unless he makes it clear what that practice was.

THE COURT: It is a preliminary question. I will allow it.

A I'm not too sure what you mean. If you are talking about the renewal annually of the advisory contract --

Q That's exactly what I mean.

A I was aware that that had happened; yes, sir.

Q When you first became a director in 1971 was there an existing Investment Advisory Agreement with the Chestnutt Corporation?

A Yes.

Q When was that Advisory Agreement renewed?

THE COURT: This is not in dispute, is it?

MR. LEE: If they will stipulate that each and

every year there has been a renewal of the agreement despite the fact that each agreement had another year to run--

THE COURT: I think that's already been testified to and there is nothing to the contrary.

MR. LITOWITZ: Your Honor, I have no reason to know whether it is the case or not. I can't stipulate to it but I don't think it is an issue in this case.

MR. LEE: I think it shows the practice of a new agreement every single year.

THE COURT: I think I already have evidence of that fact but I will permit him to answer.

Q Mr. Ulrich, since you became a director of American Investors Fund, has a new agreement been entered into in each and every year?

A Yes, sir.

Q I show you Exhibit 14A and 14B and ask you who prepared it.

A I did.

Q How did you come to prepare it?

A As a result of our considering the new Investment Advisory Agreement, the presentation to the shareholders, the annual proxy, and a discussion that we had had about possibly raising the expense limitation ratio. Really that was not the primary reason. My primary reason was just

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considering a new agreement. I went back and did some homework using Fundscope which had been supplied to me.

Q How was Fundscope supplied to you?

A It went sent to me by the officers of the Fund.

Q And when was that sent to you?

A I was trying to recall whether we got it before the May meeting or just slightly after. I am not sure but I had it in the interim. I must have had it. As I recall I went home from the first meeting and did this so I either got it at the first meeting or a day or two thereafter.

Q I show you a letter dated May 15, 1973, from Douglas Cram to the persons indicated thereon and ask you if that refreshes your recollection.

A Yes, because I must have gotten it right then and there.

THE COURT: Mark it for identification. Nothing should be shown to the witness that hasn't been marked.

MR. LEE: I offer it in evidence, your Honor.

THE WITNESS: It is dated May 15th and therefore I assume that I had it prior to the May meeting.

(Defendant's Exhibit C was marked for identification.)

xx

MR. LITOWITZ: The only question I would have is this appears to be a signed copy. I would ask where he

got a signed copy.

THE COURT: Do I understand that this is offered solely to pinpoint the date for the preparation of 14A?

MR. LEE: This is a signed copy. It is also addressed to Mr. Chestnutt and Mr. Currier and Mr. Greene. I picked this up yesterday in the files of American Investors Fund. We have a copy.

MR. LITOWITZ: I have no objection to its being admitted, your Honor.

THE COURT: But it is offered solely to pinpoint the time of the preparation of Exhibit 14A which was shortly after the 15th of May, is that correct?

MR. LEE: Yes.

THE COURT: Received in evidence.

MR. LEE: And to show that it was sent to the directors, of course, the directors who are listed there.

(Defendant's Exhibit C for identification received in evidence.)

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Q As a result of the work which you set forth on Exhibit 14A, did you reach any conclusion?

A Yes. I had two basic conclusions. One was that American Investors Fund had probably the highest number of shareholders in relation to the net assets of the Fund.

Secondly, that the investment advisory fee,

percentage, the rate, was not significantly out of line with other funds of similar size and in similar circumstances.

And then thirdly, which is probably not an issue, that American Investors Fund high turnover was in line with its investment philosophies which was the column I threw in here.

Q Are you familiar with the nature of investment advisory services generally rendered to investment companies?

A I am generally familiar. I have obviously been associated with some other funds to that extent.

Q Is there anything which distinguishes the nature of the investment advisory services rendered by Chestnutt Corporation to American Investors Fund from other services with which you are familiar?

A Yes. This fund is very unique in that the adviser is basically a technical adviser and as such I am very aware of that from being an outside director and the shareholders in this fund are buying a particular type of investment advice, and to my knowledge, I know of no other fund that has basically or has a similar type of investment analysis.

THE COURT: They are chartists?

THE WITNESS: Yes. And this creates, in my mind, since a purchaser of mutual funds has an option to pick the

type of investment service he wishes to follow, that if I were to abrogate or change the type of advice they were getting, I would be going counter to the desires of the stockholders when they made the initial decision to buy the stock.

Q I show you Plaintiff's Exhibit 1 which is a prospectus dated April 30, 1973, and ask you to identify where in that prospectus there is a reference to the type of investment advice furnished.

MR. LITOWITZ: I object, your Honor. The document speaks for itself.

THE COURT: Yes, I assume that I can find it.

MR. LEE: Very well. I just wanted him to point it out for the Court.

Q During the course of your being on the board of directors since 1971, has the question of expenses paid by the Fund been a subject of discussion at directors' meetings?

A Yes, I would say continually.

Q At the time you became a director in 1971 it's been testified, while you have been here in the courtroom, that there was a redemption effected for stockholdings of less than five shares, do you recall that?

A Yes, I do.

Q In that connection, with that redemption, was there a discussion of expenses?

A Yes, indeed. That was one of the main reasons we considered it to make sure it went through.

THE COURT: You just threw these shareholders out of the company without anybody protesting or anything?

MR. LEE: They were redeemed.

THE COURT: They were just mailed a check?

MR. LEE: No, they were sent a 60-day notice to say that they would be redeemed automatically. The by-laws were changed and we believe that's perfectly proper under New York law, and the SEC has recently given us a no action letter for redemptions less than 50 shares.

THE COURT: It is not relevant to this case.

MR. LEE: It is relevant in this sense, your Honor.

THE COURT: But he thought --

MR. LEE: Directors for years have had expenses very much in their minds and it wasn't necessary to do any window dressing to give any special study about expenses.

Q Have you discussed the expenses of the Fund with other directors at meetings of the Fund from 1971 to date?

A Other directors of our fund?

Q Yes.

THE COURT: Has it been a subject of discussion

at directors' meetings?

THE WITNESS: Yes. It's been a constant discussion. This fund happened to be one of the funds that was the most successful from the standpoint of the established purpose of mutual funds in that everybody felt that they could go in and buy a share for $3, so we ended up with the largest number of shareholders, but now it's gotten to the economics of the situation so that you can't afford to run that kind of business with the very small shareholders, and as the state laws become more and more restrictive -- although they are beginning to realize the problem -- we have constantly had this under discussion.

Our mailing costs and the costs of the Bank of New York have been constantly increasing and, as this schedule indicates, the number of shareholders per net assets is far in excess of anybody else's.

MR. LEE: No further questions.

CROSS-EXAMINATION

BY MR. LITOWITZ:

Q You made some reference to the type of investment advice given to the Fund by Chestnutt Corporation. Was there any discussion about the performance of the Fund under Chestnutt Corporation's guidance in the summer of 1973?

A There is generally a discussion of the status of

the Fund at every board meeting.

Q I show you Exhibit 7, which is an extract from Fundscope, and I ask you if that refreshes your recollection as to how American Investors Fund performed during the period January 1, 1967, to December 31, 1971.

A Yes, I have seen it.

Q Does that document show that 206 Fund reported that American Investors Fund had done the absolute dead worst of the 206 for this five-year period ended December 31, 1971?

A On this schedule it shows that but your adjectives I would - it shows that this is at the bottom of this list of this particular fund for this particular period. I don't think that that is particularly - without the text that goes behind this in Fundscope, I don't know what they were trying to prove or what that particular investment period was in the market. I know that American Investors Fund is still performing above the Dow-Jones average.

Q Is there any question in your mind that Exhibit 7 lists the funds in order of performance?

A The one they have here. This doesn't necessarily have to be all of them, I'm sure.

Q No, but of the ones listed --

A Of the ones listed it is at the bottom, there is

no question about that.

Q Is it your understanding that this shows --

MR. LEE: Excuse me. I think that we have been referring to Fundscope. I think that you should further identify this as being one of a particular monthly issue of Fundscope and not from its annual --

THE COURT: It speaks for itself anyway, gentlemen. I think we are wasting time.

MR. LITOWITZ: Your Honor, in that regard, if I might, we stipulated as an exhibit the two pages, 117 and 118. If I could I would like to mark for identification as Exhibit 7A the entire magazine so your Honor can have a better view of from where it is taken. If there is no objection by Mr. Lee.

MR. LEE: No objection.

THE COURT: All right, it will be received in evidence.

(Plaintiff's Exhibit 7A for identification was received in evidence.)

xx

Q In the summer of 1973 when a discussion was centering around changing the expense limitation, did anyone discuss the performance of American investments for the period preceding that time?

A We discussed the performance, as I say, at every

meeting, as to what the status of the Fund's shares were, what the condition of the market was.

The point you are trying--

THE COURT: No, don't volunteer, please.

Q Did any of the directors suggest that since the Fund had done rather poorly, that the 1 per cent limitation should have been kept in effect?

A No, sir. They didn't necessarily consider that the fund had done poorly in view of the investment type philosophy and the action of Dow-Jones at that point, the action of the stock market at that point. Perhaps it has not done well but --

Q Now I believe you testified that it was your belief and it was clear to you from your Exhibit 14A that you prepared, that American Investors Fund had a higher number of shareholders to net assets as compared with other funds, is that correct?

A I said it was among one of the highest, yes.

Q To your knowledge, did that same situation exist in the summer of 1972?

A I would assume it did. That's an assumption.

Q So that relationship of high number of shareholders to net assets was something that didn't suddenly occur after the '72 Advisory Agreement was put into effect, isn't that

correct?

A That is basically --

Q Did anyone tell you that the SEC wanted to have, in the proxy statement, some words to the effect that American Investors Fund was charged a higher rate of fee than other funds?

A No, but I don't think I would have agreed with it.

Q But in any event, no one told you that, is that correct?

A I have been involved many times with comment letters on documents presented to the SEC for final approval.

MR. LITOWITZ: Your Honor, this is not responsive.

THE COURT: Yes, I will strike it out as not responsive. The question is whether anybody told you at or before the time that Exhibit 25 was issued. That could be answered yes or no.

A No, they didn't.

Q Mr. Witness, have you ever served as a director of a public corporation?

A No.

Q Could you tell us how you happened to become a director of American Investors Fund?

A Mr. Lee, who was my next door neighbor, asked if I would be interested and I said yes and I met with Mr.

Chestnutt and Mr. Sabel whom I had met previously and they asked me to become a director.

Q How long had you known Mr. Lee before he asked you to be a director of American Investors Fund?

A Since 1960.

MR. LITOWITZ: No further questions.

THE COURT: Anything else from this witness?

MR. LEE: Yes, your Honor.

REDIRECT EXAMINATION

BY MR. LEE:

Q Mr. Ulrich, during the course of your business career and your professional career with Arthur Anderson had you had occasion to deal directly with the SEC?

A Yes, sir.

Q What sort of dealings have you had with the SEC?

A Well --

THE COURT: Is this relevant?

MR. LEE: Yes, sir. He was asking the extent to which, asking about the information with respect to proxy statements.

THE COURT: All right. I willtake it.

A I have answered their comment letters on proxy statements and registration --

THE COURT: You wre doing this in your capacity as an accountant?

THE WITNESS: Yes.

Q And also --

THE WITNESS: Both as a public accountant in advice to a client and in the case of Sinclair.

THE COURT: Were you a director of Sinclair also?

THE WITNESS: Oh, no.

Q In what way do the directors know as to the market performance of American Investors Fund?

A We received a weekly listing of all stock purchased, sold, a listing of the portfolio, and a balance sheet which comes in the mail.

Q Is there anything else contained in that report, weekly report?

A We also get Mr. Chestnutt's market advice letter.

Q I am talking about your directors' report, is there anything else contained in it?

A (No response.)

Q Any data?

THE COURT: Could I see the prospectus?

You may continue.

A Well, it has the purchases of the shares, what were bought and sold.

Q Does it show the market performance of fund?

MR. LITOWITZ: I object. He is leading the witness.

THE COURT: Well, that's not necessarily leading. Does it or doesn't it.

Q Does it show any comparison between the Fund and the market?

A I'm not with you. I don't know which part you are talking about. It's got the market values and it gives the net value of the individual stocks in the portfolio.

MR. LITOWITZ: I object, your Honor. He is trying to lead the witness.

THE COURT: Why don't we start right back at the beginning.

What, if anything, do you receive between meetings from American Investors Fund and Chestnutt?

THE WITNESS: We receive this weekly report that I am talking about with all of the purchases and all of the sales of shares.

It's also got a listing of the portfolio, stocks.

We also get Mr. Chestnutt's news advice as to which way he considers the market is going: that report does have a balance sheet in it.

THE COURT: As I understand it, the investment objectives aren't restricted to following charts solely,

isn't that right?

THE WITNESS: There is a certain portion of fundamentals but it is primarily a statistical, based on the market action itself.

THE COURT: And you say that that is unique, that that is not commonly used by other investment funds.

THE WITNESS: I don't know anybody that professes to use it as strongly as our prospectus indicates it is done.

THE COURT: Anything further, Mr. Lee?

MR. LEE: No further questions.

THE COURT: Anything else?

MR. LITOWITZ: I have none, your Honor.

THE COURT: All right, you may step down.

(Witness excused.)

MR. LEE: Your Honor, may we resume after lunch?

THE COURT: All right. Ten minutes of 2.

MR. LEE: Very well, sir.

(Recess to 1:50 P.M.)

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AFTERNOON SESSION

1:50 P.M.

MR. LEE: Mr. Mumbach, please.

P E T E R G. M U M B A C H, called as a witness, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LEE:

Q What is your occupation, Mr. Mumbach?

A I am treasurer of American Investors Fund and controller of Chestnutt Corporation.

Q In connection with your duties as controller of the Chestnutt Corporation, can you tell us whether Chestnutt Corporation, in 1973, operated at a profit or loss?

A We sustained a loss.

Q How much?

A $248,000 before provision for a refund in taxes.

Q Can you tell us?

THE COURT: This is calendar year '73.

THE WITNESS: Yes, sir.

Q Can you tell us what the results were for the year 1974?

A We don't have figures yet but my approximation would be that they would be in the neighborhood of 180 to

$200,000.

Q What?

A 180 to 200 thousand dollars loss.

Q Loss?

A Yes.

Q Thank you.

In connection with the American Investments Fund for the calendar year 1974, has the audit been completed of American Investor Fund?

A It has, yes.

Q And the Xerox has been signed by the independent accountants?

A It has.

Q And who are the independent accountants?

A Price, Waterhouse & Company.

THE COURT: What fiscal year are we talking about?

MR. LEE: Calendar year of 1974.

Q Will you please state to the court what the expenses were in 1974?

A May I refer to a document?

Q Please do.

THE COURT: Any document referred to should be marked for identification.

A It is the annual report.

(Defendant's Exhibit D was marked for identification.)

THE COURT: As I understand it, he is just using this document to refresh his recollection.

MR. LEE: Yes, your Honor.

MR. LITOWITZ: I have never seen it before.

Q Do you know when it was mailed, Mr. Mumbach?

A Last week.

MR. LITOWITZ: Will I be provided with a copy of this, Mr. Lee?

MR. LEE: I will give you a copy, yes.

I offer it in evidence, your Honor.

THE COURT: All right, received in evidence.

(Defendant's Exhibit D for identification was received in evidence.)

THE COURT: You may continue.

MR. LEE: Yes.

Q Do you have Exhibit D in front of you, Mr. Mumbach?

A Yes. The total expenses were $1,448,139.

Q Did you make any computation as treasurer of American Investors Fund as to the expense ratio for the year 1971?

A I did.

Q In what manner did you make such computation?

A We made it under the present advisory contract, 1-1/2 per cent.

Q Tell me how you calculated it, what figures you used, what figures you took into account?

A The computation is based on a limitation on the annual expenses of the Fund, and you take the monthly, average monthly net assets. So in effect you take the beginning assets of the year and the 12-month end net asset figures, average them out, apply your expense limitation percentage against that and compare that to your total expenses and see whether you are --

Q When you say the beginning net assets, those are assets as of what date?

A As of January 2nd, the beginning of the fiscal period.

Q So do I understand you correctly to say that you take 13 figures into account?

A Correct.

Q What is the source of your taking 13 figures into account rather than 12?

A Well, it would be normal method of averaging but specifically we have used the method as outlined in the instructions to the N1R report to arrive at a 13-month figure period.

Q And the N1R report is the annual report required to be filed with the SEC, is that correct?

A Correct.

Q How thick is the N1R with exhibits?

THE COURT: Sustained. It is too thick. Let's go on to something else. If you want to offer it in evidence, offer it.

MR. LEE: That's the last thing I want to do.

Q Did you make any calculations for the first six months of the year and for the second six months of the year as to expenses?

A I did, at your request.

Q What were the expenses for the first six months of the year?

A They were, if I recall, in the neighborhood of 800,000.

Q What were the expenses for the second six months of the year?

A Somewhat in excess of 600,000.

Q Did the figure of 1,448,139 which you mentioned exceed the 1-1/2 per cent expense limitation that is provided in the contract?

A No, it didn't. In fact, I believe it was a cushion of close to $400,000.

Q Now, taking the two periods separately, and looking first at the last six months of the year--

MR. LEE: And I take it that counsel concedes that he has no claim for expense overruns in the second six months of the year?

MR. LITOWITZ: Counsel doesn't concede anything about the six months.

Counsel's contention is that the issue is for the period July 1, 1973, to June 30, 1974. We get to June 30, 1974, by the fact of a new Advisory Agreement put into effect in 1974, effective September 1, 1974, but under which the fee is computable as of July 1, 1974, by the provision that was contained in the old agreement and what we call the new agreement, and also the '74 agreement.

MR. LEE: My request is that the plaintiff's stipulation on the record that they concede that a 1-1/2 per cent expense ratio is perfectly proper as being adopted in the 1974 annual meeting.

MR. LITOWITZ: We will not stipulate to its propriety. We will stipulate that it is not in contention in this lawsuit and that the 1-1/2 per cent ratio becomes effective for purposes of this lawsuit from July 1, 1974, forward.

THE COURT: You could not tell until June 30, 1975,

whether it had been exceeded; isn't that so?

MR. LITOWITZ: For the first year under the newest contract, that's true.

THE COURT: All right. Now what about the year ending June 30, 1974? Do we have any data as to the first six months?

MR. LEE: I am going to ask the witness as to the first six months' expenses.

THE COURT: Before you leave this Exhibit D in evidence, I think the court would like to know how much of this represents accruals, or is this entirely on a cash basis, or how do you handle these items.

THE WITNESS: Accrual basis, your Honor.

THE COURT: They are all on an accrual basis?

THE WITNESS: Yes, sir.

THE COURT: Where are the footnotes?

THE WITNESS: On the back.

THE COURT: Oh, I see it.

You may continue.

Q Mr. Mumbach, what were the expenses for the first six months?

A Of 1974?

Q Yes.

A I think I answered approximately somewhat over

$800,000.

Q And what were the expenses for the second six months

A Somewhat over 600,000.

THE COURT: We had that but isn't it possible to get precise figures at this point?

THE WITNESS: I do have some.

MR. LITOWITZ: If I may, I think one of the semi-annual reports has the expenses. I think it is Exhibit 24.

THE COURT: Broken down by six months' periods?

MR. LITOWITZ: Yes.

THE COURT: All right.

MR. LEE: Let me show this to Mr. Mumbach.

Q I show you Plaintiff's Exhibit 24. And you will have before you also Defendant's Exhibit -- the annual report so that you can have the two of them together.

A All right.

Q Now, if you subtract the approximately 800,000 figure from one million four forty eight --

A You would get $641,000 for the second six months of 1974.

Q By how much did such $641,000 fail to reach the 1-1/2 per cent expense ratio as calculated on the 13 figure average?

A Could I ask you if I could enter my computations? I have them with me in my briefcase.

MR. LEE: May the witness please go to his briefcase?

THE COURT: Yes, certainly. He may step down and obtain his briefcase.

As I understand it, it's just been conceded by plaintiff that they raise no issue in this lawsuit concerning expenses following July 1, 1974.

MR. LEE: Yes, your Honor, but we maintain that on either of two bases of computations there is absolutely nothing that is conceivably owing for 1974 because we are compelled under the Security and Exchange Commission regulations to take this on an annual basis.

THE COURT: But do you both agree that the annual basis is the year ending June 30th in each case?

MR. LEE: No, your Honor.

THE COURT: That is plaintiff's position but not the defendant's?

MR. LITOWITZ: That is plaintiff's position, your Honor, that the contract was for two years and --

THE COURT: And what was the year under the contract?

MR. LITOWITZ: The effective year under the contract that is in dispute is July 1, 1973, to June 30, 1974.

THE COURT: And you, Mr. Lee, don't agree with that?

MR. LEE: We say that the computation must be made in accordance with the contract on an annual basis.

THE COURT: Covering what 12-month period?

MR. LEE: We do it two ways, your Honor.

THE COURT: What do you claim the contract provides?

MR. LEE: The contract provides for an effective rate beginning July 1st and a prospective for two years.

Now, for the purpose of the computation of the expense ratio, it is on an annual basis. We believe that the amount by which we fail to exceed the 1-1/2 per cent in the second six months may be offset against any amount which exceeded the 1 per cent in the first six months even though we maintain that the effective rate was 1-1/2 per cent.

THE COURT: Hand up the contract, please.

All right, you may continue.

Give me the old one, the first one.

MR. LEE: I ask that four sheets of paper be marked Defendant's Exhibit E for identification.

(Defendant's Exhibit E was marked for identification.)

Q Mr. Mumbach, did you prepare Exhibit E marked for identification?

A I did.

Q And when did you do this?

A Several days ago.

Q At whose request was Exhibit E prepared?

A Mr. Lee's.

Q Can you tell us what Mr. Lee told us when he asked you to prepare this exhibit?

A He told me to prepare an exhibit for the entire year of 1974 under the present contract; an exhibit under the old contract for the entire year 1974; and then to break them down into two -- 1974 into two separate six-month periods; and also make a computation each of those.

Q Did Mr. Lee tell you to use, in figuring the monthly net assets, a January 2nd calculation for a figure?

A No.

Q Can you tell us why that figure was used?

A That is the figure we always use every year.

Q When you say you always use --

A As I explained to Mr. Lee before in one of his questions on the computation of the limitation, you take a 13 period in order to arrive at an average monthly net asset, in order to start at the beginning of a period. The beginning of our fiscal year is January 2nd. And then you take the month end net assets.

Q When you say you take those figures, are you saying that in filling out a Form N1R that there is a place for 13 figures and a request --

A No. N1R --there is no specific place in N1R where a computation is called for for average monthly net assets to arrive at this 1 per cent limitation. The limitations are from various states. But since we have had the 1 per cent limitation and now the 1-1/2 per cent limitation in effect, going back to 1967, we had to arrive at some method of computing this on an annual basis. We couldn't find any place that showed how to make this computation of average monthly net assets.

The only place that we found anything that we could tie into was in the instructions to N1R where they specifically point out, in arriving at another ratio, an annual ratio, using a monthly average, they specifically point out using 13 periods, using the end of each month and the beginning date of the first month of the fiscal year.

Q And what are the comparable figures that are used that you look at in making your analogy?

A I'm sorry, I don't follow you.

Q You said that the N1R didn't deal with the average monthly net assets.

A Oh, this is in computing the portfolio turnover

ratio, they take the first business day of the year and then take the month end to figure a turnover?

A Right. We have used that method since 1967 when I believe we took the 1 per cent into account, and each year our auditors have passed on this method and have never raised a question as to the method being used.

MR. LITOWITZ: Your Honor, I would object to the use or attempt to arrive at an average monthly net asset figure that takes into account the first business day of the year.

We have made a calculation in our memorandum where we have gotten figures from the defendants for the month end, in figuring the average monthly net assets we have taken the last day of the 12 months that we feel are in dispute. I don't see any basis for using a beginning of the year figure. I can certainly understand it in the turnover ratio where you want to see where you started from, the first business day of the year and as the fund turned over, but to get an average figure, to take an average monthly net asset figure, I do not think it should include a beginning of the year calculation.

THE COURT: Well, you see, that would not give you the basis for an objection as to admissibility. You are entitled to compute it in any way that you think reasonable,

and if the record shows there is a practical construction which has been placed on this contract and they have been using a 13-month method of averaging, as you described, since 1967, both parties and their Certified Public Accountants, I think what they have done is admissible. It is conclusive on your client as to whether it is the right way to do it or not. That may be a different question. But as far as admissibility is concerned, I will overrule your objection.

I don't know if the result would be different if they took a mid-month date. I supposed there are a number of reasonable ways you could find an average asset value during the year taking it from day to day. I suppose with modern computers you can do it on a daily basi without too much difficulty.

All right. Is there anything further about this statement?

MR. LITOWITZ: I would say that it appears that there are two first pages which -- this is the same, isn't it?

MR. LEE: By Mr. Lee.

Q Are there two first pages to this?

A I don't believe there should be. The first is under the present contract of 1-1/2 per cent.

THE COURT: Let's get this for the record.

A The first schedule here is the computation of the '74 expense limitation as per the contract so it is at 1-1/2 per cent.

The second schedule is the 1974 expense limitation assuming that the old 1 per cent limitation was still in effect.

THE COURT: For the first six months of the calendar year?

THE WITNESS: For the entire year.

THE COURT: The entire year?

THE WITNESS: Yes.

And then the last two in the schedule: one is for the first six months and the second is for the second six months.

MR. LEE: I offer it in evidence, your Honor. And I will have that typed. It is very poor for reading. I will have it typed.

THE COURT: There is some other exhibit, while we are on the subject, where the Xerox is practically legible.

MR. LITOWITZ: Another objection I would raise, your Honor, is that it goes beyond the period plaintiff, of course, contends is in dispute in that it goes beyond June 30, 1974.

THE COURT: Well, you see, he can defend on any theory he wants. Whether the court agrees with him or not

doesn't have any bearing on the admissibility of the exhibit, or whether you agree or not doesn't.

I will take the exhibit. I will say that any of you who wish to submit different analyses may do so.

(Defendant's Exhibit E for identification was received in evidence.)

xx

BY MR. LEE:

Q Mr. Mumbach, turning to the year 1973, the calendar year 1973, what were the expenses in 1973?

A I believe they were in the neighborhod of 1,900,000.

Q I show you Plaintiff's Exhibit 15 and ask you who prepared that.

A Individuals in the accounting department.

Q Under your supervision?

A Correct.

Q What was the expense ratio for the fund, for the calendar year 1973?

A For 1973?

Q The calendar year 1973.

A I believe it was slightly over --

THE COURT: Aren't there documents so we don't have to have answer like I believe it was slightly over some certain figure? Isn't there a matter of precise knowledge somewhere

here in this record?

MR. LITOWITZ: I believe it is, your Honor. There is an annual report for 1973 that has the figure somewhere in it.

THE COURT: Let's try to deal with exact figures if we can. Show the witness the annual report, please.

When did Chestnutt Corporation become the adviser of this fund?

THE WITNESS: 1957. They organized the Fund in 1957.

THE COURT: Is there a date?

MR. LEE: Chestnutt Corporation itself, your Honor, became the adviser in 1966 when it took over from what was then known as American Investments Corporation, a New York corporation through a statutory merger. The defendant Chestnutt Corporation is a Connecticut corporation. Prior thereto American Investments Corporation had been the adviser since about 1960.

Prior thereto the adviser was a New York limited partnership known as American Investments Company, and American Investments Fund itself was incorporated in 1957. It made its first investment in January, 1958.

THE COURT: So that there was a continuity of advisers through successor entities since January 1, '68.

MR. LEE: That's correct.

THE COURT: Do you agree with that?

MR. LITOWITZ: You said '68. I think it is '58.

MR. LEE: 1958.

THE COURT: 1958. Do you agree with that?

MR. LITOWITZ: Controlled in effect by Mr. Chestnutt.

THE COURT: I understand there was a limited partner; there was a merger by which this Connecticut corporation and the Chestnutt corporation became the successor in interest of the New York corporation, is that what you are telling me?

MR. LEE: That's correct.

THE COURT: And you all agree that that is a correct statement of fact?

MR. LITOWITZ: That's right.

MR. LEE: That's correct.

THE COURT: Thank you.

Is there any explanation as to why the agreements are made as of September 1st and apparently the charges therein measured by July 1st fiscal periods since the relationship began in January.

MR. LEE: I can make a statement on the record if you like.

THE COURT: I will take it subject to your adversary's acceptance. If it is accepted, then there is no need to bring in proof.

MR. LEE: The annual meeting of the Fund has always been in July.

THE COURT: Pursuant to its certificate?

MR. LEE: Pursuant to its by-laws, yes.

And in July, that's the time when it was taken up, and it is always related back to the preceding July 1st, and; for the last several years at least, I know it's been dated as of September 1st. There may have been some time when it was dated July 1st.

Q I show you Plaintiff's Exhibit 13 and ask you whether you can find from there what the expense ratio was for the year 1973, the calendar year.

A In 1973 it was 1.02 per cent.

Q From the amount set forth as expenses in the statement, is there any amount to be deducted in accordance with the contract?

A There would be the state taxes, 10,600, and a minor amount of interest. I don't have that figure at hand here.

Q If I show you Exhibit 15, could you find the amount of the interest?

A And the interest for 1973 was approximately $1,806.

Q Now taking the taxes and the interest, and subtracting them from the expenses listed on the published statement, what is the amount of expenses to be taken into account for calendar year 1973?

A It would be $1,691,000.

Q Now, have you made any calculation as to what the expense ratio was on that basis?

A For 1973?

Q For 1973; yes. Calendar year 1973.

A We did, back at the end of that year, and we came up with those two expense items, as I said, which were just slightly over 1 per cent. In other words, you would have to carry the percentage out substantially to -- for all intents and purposes you could say it was 1 per cent.

MR. LEE: No further questions.

CROSS-EXAMINATION

BY MR. LITOWITZ:

Q Mr. Mumbach, you said that the Chestnutt corporation incurred a loss for its calendar year 1973, is that correct?

A That's correct.

Q Did part of that loss reflect the operations of Cascade Airways?

A Yes.

Q And did Cascade Airways contribute to that loss?

A It contributed to it.

Q Let me rephrase the question. Did Cascade Airways operate at a loss itself?

A In '73?

Q Yes.

A Yes.

Q So that the Chestnutt Corporation's loss included some portion of the Cascade loss, is that correct?

A Yes.

Q Do you know the size of the Cascade loss?

A 29,000, I would say. 29; yes.

Q And what portion of the 29,000 was included in the Chestnutt Corporation loss?

A The entire amount.

Q Mr. Mumbach, are you a lawyer?

A No.

Q Can you tell us your educational background?

A I graduated from St. John Fisher College in 1970 with a degree in accounting and subsequently became a CPA.

Q Could you trace your employment from the time you graduated college to the present?

A Following graduation I joined Price, Waterhouse & Company and I was with them for approximately until May of 1967 when I joined the Chestnutt Corporation.

Q And you have been with Chestnutt from 1967 to date, is that correct?

A To date, correct.

Q When you make these computations of the expense limitation and the potential rebate, do you look at the contract between American Investments and Chestnutt Corporation?

A Do I look? I think I did a number of years ago since the contract really hasn't changed in that respect. There hasn't been a need to refer to it in a number of years.

Q Did you attempt to interpret that contract yourself or did someone else advise you how that was to be computed?

A As far as the 1 per cent?

Q Yes.

A Limitation?

Q Yes.

A I don't believe anybody advised me, no. Perhaps our auditors did. It was being computed when I joined the firm, and so I mean there was a basis already established for computing the expense limitation.

Q And that basis was done on an annual year?

A On an annual year.

THE COURT: Calendar year?

MR. LITOWITZ: I'm sorry. Calendar year.

A In fact, our statements, I believe, make that point in one of the footnotes that the computation is against the annual expenses of the Fund, the limitation is against the annual expenses of the Fund.

Q When it says annual, that could be of course a contract year or a calendar year. Are you familiar with the differences in those two terms?

A I am, but in the history, since 1967, we have always maintained it on an annual computation basis and, in fact, our quarterly reports have so noted in the footnotes a statement to the effect that the limitation -- maybe I can read it from one of your exhibits here.

This is from your Exhibit 24. For the six months ended June 30, 1974, the fee has been accrued without regard to any such limitation, referring to the adviser contract, which will not be determinable until the end of 1974.

Q Is the Fund required to file an annual report with the SEC?

A Oh, yes. Form N1R.

Q As part of that reporting is the Fund required to

state the assets for that calendar year?

A Yes.

Q And does the Fund send out an annual report based on the calendar year to its shareholders?

A Yes.

Q Doesn't the report traditionally reflect the--

A I'm sorry?

Q Did the annual report to shareholders, has there generally been an indication of the expense ratio for the calendar year?

A No. Usually there is a footnote to the effect that no payment has been required under the provisions of the expense limitation.

Q I'm not talking about the payment. Is there frequently appearing in part of the table just a statement as to the expense ratio for the given calendar period?

A Yes, during the last two years there is a five-year summary table appearing in the report which shows the expense ratio for the year.

Q So the expense ratio is computed on a calendar year for submission to the SEC, is that correct?

A Correct.

Q And the expense ratio is also computed on a calendar year for inclusion in the annual report to

shareholders, is that correct?

A Right.

Q Is the expense ratio computable on a contract year based on quarters within a given calendar year?

A Not to my knowledge, no.

Q Would you be unable to compute the expense ratio for the period July 1, 1973, to June 30, 1974?

A Would I be unable to?

Q Yes.

A No. I could compute it, but, I mean, I don't believe it would mean anything, really, because--

Q Well, wouldn't that in fact explain what the expenses were in relation to the net asset value during that period, July 1, 1973, to June 30, 1974?

A I'm sorry, I didn't follow you on that.

THE COURT: I think that is a self-evident question. I think the answer has to be yes. Let's go on to something else.

Anybody can make this computation, couldn't they?

THE WITNESS: Correct.

Q When did you first learn of this lawsuit?

A When did I first learn of it?

Q Yes.

A Either the latter part of June or July of 1973.

Q From that time --

A Just prior to the annual meeting.

Q From that time to the present , have you had occasion to speak to people at Chestnutt about this lawsuit?

A From time to time.

Q Who makes the decision at Chestnutt Corporation as to whether an expense of the Fund should be accrued currently or somehow deferred?

A I would say I do.

THE COURT: What type of expenses are determined?

THE WITNESS: If we prepaid an expense, or something of that nature. Such as, we belong to the Investment Company Institute and if we pay dues in advance for the year, we might defer them over the entire -- if the payment was, say, made in September, we would defer it.

Q Can you identify any expenses that were deferred beyond June 30, 1974?

MR. LEE: I didn't hear the date that you said.

MR. LITOWITZ: Beyond June 30, 1974.

A I can't, no. Not off the top of my head.

Q Did anyone at Chestnutt discuss with you the idea of deferring certain expenses beyond that date for purposes of this lawsuit or for any other reason?

A (No response.)

Q Have you deferred any such expenses?

A No. Our statements and records have been kept in accordance with the rules and regulations. I think that would be the last thing we would want to do. In fact, I might add, our auditors wouldn't allow it, really.

Q You wouldn't want to get into a fight with the SEC about that?

A No. And we have -- our statements at our June 30, 1974, statement is an audited statement, so even if we tried to go against normal accounting practice, I mean, our auditors wouldn't allow us to.

Q Did you make any statistical study of fund expenses prior to June, 1973, for any purpose?

THE COURT: Prior or including '73?

MR. LITOWITZ: Thank you, your Honor.

A I don't believe so, no.

MR. LITOWITZ: No further questions.

MR. LEE: Your Honor, I wasn't sure I heard one answer.

REDIRECT EXAMINATION

BY MR. LEE:

Q This has to do with this method of deferred expenses or perhaps prepared expenses. Did I understand you to answer a question relating to that?

A I said that if there was an item that would normally be -- such as, if we prepaid our dues to the Investment Company Institute and they extended over the whole year but we say paid them on June 30th, we would defer part of them based on the benefit.

Q How about if I dealt bonds?

A The same with that.

Q Any of those prepaid?

A Yes. That normally is a three-year policy.

Q Are prepaid expenses shown on the annual statement?

A No, not as a separate item. That would be in other assets.

Q What is the order of magnitude of the aggregate of any such prepaid expenses in their entirety?

A For 1974?

Q Yes. Give us both years if it is convenient.

A 1974, they would be, I would say, $7,784.

And in 1973, $10,125.

Q Mr. Mumbach, what was the effective rate of the advisory fee for the calendar year 1973?

A Slightly over 5/10 of a per cent.

Q Do you happen to know exactly what it was since it's been published?

A It is published but I don't have it at the tip of my

tongue.

THE COURT: But it can be computed, can't it?

THE WITNESS: It is in the prospectus.

MR. LEE: May I refresh the witness' recollection?

THE COURT: Isn't the prospectus in evidence?

MR. LEE: Yes.

Q Can you give me the figure for 1974?

A 1974? It is .61 per cent.

MR. LEE: No further questions.

RECROSS EXAMINATION

BY MR. LITOWITZ:

Q Mr. Mumbach, you used the phrase effective rate of advisory fee. Can you tell us what you mean by that?

A I didn't use that phrase. I believe counsel did.

THE COURT: You adopted it when you answered the question. What does that phrase mean to you?

THE WITNESS: That is the actual fee paid during the year against the average monthly net assets.

Q Without --

THE COURT: Without regard to the steps.

THE WITNESS: Correct.

THE COURT: It is the actual fee paid during the year?

THE WITNESS: Yes.

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Q Can an effective rate be computed as of a point in time? By that I mean, expenses are running at X level and the net assets are at such and such a level, and therefore the effective rate is such and such?

A I would think you could; yes.

THE COURT: Well, expenses don't enter this, as I understand it.

MR. LITOWITZ: That's right.

THE COURT: He is talking just about the fee.

MR. LITOWITZ: That's right.

Q Taking the Judge's correction, just taking the level of assets at a given point, you can say at that point the effective rate is such and such?

A Correct.

Q So that would mean that under the rate charged to American Investments of .8 of a per cent on the first 50,000,000, dropping down to .6 on the next 50,000,000 and .4 on a certain sum beyond that, that at 150,000,000 of net assets, the effective rate would be an even .6 of a per cent?

A That's correct.

Q And if the net assets fell slightly below, that would mean the effective rate was somewhat above .6?

A Correct.

Q And if you were then going to figure the expense ratio, could you then take the point at which the assets are at thehypothetical 150,000,000 and then see current rate of expenditures and figure a current expense ratio? Is that possible for computation?

A At a particular point in time, yes.

Q Could that have been done in the summer of 1973?

A It could have, yes. The problem is that you are not taking any variables into consideration in that case, and therefore it really doesn't--

Q I understand. You are just taking an effective rate as at a point in time?

A Yes.

Q So on June 5, 1973, one could have taken the net assets at the close of business and taken some figures as to expenses and computed that ratio as of that date, is that correct?

A Correct.

THE COURT: That's a different example that you are talking about now. You are talking about spot asset value and accrued period expenses, aren't you? I'm not sure I understand the thrust of the last question.

Do you understand it?

THE WITNESS: Yes.

THE COURT: All right.

THE WITNESS: There is only a fallacy there in that the advisory fee is only paid at the end of each quarter on the net assets in effect at that particular date, so as I say, when you pick a particular day to compute your expense limitation, you could be way out in left field. There are all ways you can go.

THE COURT: You are taking your 13-month average for purposes of computing your limitation but you are paying based on four quarterly resumes.

THE WITNESS: Correct.

THE COURT: All right.

MR. LITOWITZ: No further questions.

MR. LEE: No further questions.

THE COURT: All right, you may step down.

(Witness excused.)

MR. LEE: Your Honor, may I have a short recess and then I will call Mr. Chestnutt.

THE COURT: Surely.

MR. LEE: Your Honor, I have one other witness, Mr. Currier, who I have been trying to reach, and if I could conclude with Mr. Chestnutt and put on Mr. Currier at 11 o'clock tomorrow, I would appreciate that and conclude the trial at that time.

THE COURT: All right, we will take a ten-minute recess.

(Recess)

G E O R G E A. C H E S T N U T T, a witness called by defendant, having been previously sworn, testified as follows:

MR. LEE: In view of the fact that Mr. Chestnutt's positions are described in the deposition, I will just skip that part, your Honor, and proceed.

THE COURT: All right.

DIRECT EXAMINATION

BY MR. LEE:

Q Mr. Chestnutt, will you just sketch briefly the history of American Investors Fund?

A American Investors Fund was incorporated in 1957, but it didn't make its first investment until January 16, 1958.

At that time its adviser was American Investments Company, a limited partnership of which I was the sole general partner.

Q What business was American Investments Company in prior to the time American Investors Fund was formed?

A Investment advisory service was the principal business. We also did some investment counseling business. We

published a weekly market letter based on technical market analysis.

Q Would you describe briefly what that technical market analysis is?

A It assumes that the market knows more about what's going on than any one individual and can tell its own story based on the analysis of the buying and selling of individual stocks and the whole market in general.

Q In that connection, what do you do to reflect that?

A We analyze such things as the volume of sales, price changes on a daily basis, and the ratio of all the price changes on the New York Stock Exchange in relation to the volume that takes place on both up side and down side in an effort to determine whether stocks are moving more easily on up side buying or on down side buying.

In general, the less volume that a company moves is more likely it is to continue because it means there is not much opposition to that direction of flow.

We also measure the momentum of the market in the sense that we make various mathematical calculations that show whether the trend is slowing down or speeding up in a certain direction and you can make certain projections from that as to the probable continuation of the trend.

Q What is it that Chestnutt Corporation and its predecesso

publish? Will you describe that briefly to the court?

A We publish, first, a two-page market letter that I write. Then a tabulation of a thousand stocks that are ranged in descending order of what we call market strength in which the top ten out of the thousand are given a rating of 99, the next ten 98, and so on down to zero, which is a computerized analysis where the computer is standing where we are today and looking back over where the stock has been and determining on an average basis whether that stock is going up or down, and how steeply it is going up or down.

The same formula is applied to every stock, and then you take the strength figure for each one and arrange them in descending order of those figures.

We also follow 70 industry groups on the same basis, and we have our own 1,000-stock average, and all of our market averages, the industry group handling stock averages, are geometric averages, a system that I developed back in the 1940s, which success is in giving every stock exactly the same weight as every other stock. It is unique in that respect.

Q And are those sent to subscribers to the service?

A Yes.

Q Now you mentioned investment counseling. What is that?

A That is a relatively small part of our business but in that area we manage individual accounts for individual people and corporations, and a few pension and profit sharing funds.

Q During the time that American Investments Fund has been in existence, have you at all times been the principal, chief executive officer?

A Yes.

Q What was the initial advisory fee when the Fund was formed?

A 1 per cent per annum.

Q Did there come a time when that was changed?

A In 1964 we adopted a sliding scale similar to the one we have today except that beyond the half a billion level it kept on going down. Instead of stopping at 3/10 of 1 per cent, it went on down; and over a bill it was as low as 1/10 of 1 per cent.

I woke up one day and realized that that could put us out of business some day if we ever got fortunate enough to have way over a billion dollars in the Fund, so I re-thought that one and in 1964 I proposed to the directors that we should eliminate that. Not '64; '68, I should say.

Q At the time the Investment Advisory Agreement was changed to reduce the rate from a flat 1 per cent, was there an

existing agreement between the Fund and the adviser?

A Yes.

THE COURT: By agreement you mean an agreement in writing?

MR. LEE: Yes, a written agreement.

THE COURT: Do you understand the question?

THE WITNESS: Yes.

Q Had that agreement reached the point of termination or expiration?

A No. It still had a year to go, over a year.

Q So that when the agreement had a year to run, you decreased the advisory fee, is that correct?

A That's correct.

Q And was that done through a vote of the stockholders of the Fund?

A Yes.

Q Now, you mentioned in 1968 that it was changed again. At that time was there an existing agreement?

A Yes.

Q Written agreement?

A Yes.

Q Had the agreement expired?

A No.

Q And what was the effect of the change in 1968?

A It had no immediate effect because the Fund was below the levels where any of the changes would take place, but had the Fund continued to grow beyond certain limits, it could have caused the Fund's advisory fee to be higher than it would have been under the earlier contract.

Q At the time when the Fund was started, was there any expense ratio limitation in the Investment Advisory Agreement?

A No.

Q When did an expense ratio limitation first come into an Investment Advisory Agreement?

THE COURT: Of this fund?

MR. LEE: Yes.

A In 1967, I believe. I'm speaking from memory. I'm not sure.

Q What was the occasion for that change?

A The State of California passed a regulation of some sort that they would require an expense ceiling of 1 per cent as a condition of any fund continuing to sell in the State of California.

We were asked to make an undertaking to the effect that if we wished to continue selling in California, that we make an undertaking to the effect that if the expense ratio went over 1 per cent, the adviser would refund the

excess to the Fund.

As a further condition, they required that we incorporate it in this Investment Advisory Agreement that would be coming up during the next year.

They said "Okay, we will accept your undertaking for now, but will you put it into your next Advisory Agreement?"

Well, not wishing to discontinue selling in the biggest state in the union as far as population and shareholders is concerned, we decided that that was a calculated risk that we would be willing to take.

So we went ahead and voluntarily put into the next agreement, and of course, as usual, the agreement was ratified by the shareholders.

Q Has there been any change in the State of California since that time?

A Some time about -- well, on the order of a year or a little over a year ago they modified those too to make the limitation 1-1/2 per cent on the first 30 million, and 1 per cent on the excess over 30 million.

Then some time later still they changed it again and made it 2 per cent on the first 10 million, 1-1/2 on the next 20 million, and 1 per cent on the excess.

Now, the exact dates of those changes I can't tell

tell you, but they are all within about the last two years, and I think the first one was about one and a half years ago and the other one much more recently.

Q Have the California limitations been the subject of discussion at meetings of the board of directors of the Fund?

A Yes.

Q When, if you know, was the first discussed?

A Around the time in 1967 when we were changing the agreement to reflect the 1 per cent limitation.

Q Other than Mr. Ulrich and myself, areall the members of the board who were members of the board in 1973, were they all members of the board of directors in 1967?

A Yes.

Q So that except for Mr. Ulrich and myself, all of those directors would have been familiar with the expense ratio limitation as early as 1967, is that correct?

A Yes.

Q Based upon your experience, Mr. Chestnutt, and you have been in the courtroom during the course of this trial, what can you say are the principal elements of out-of-pocket expenses of an investment company other than the advisory fee?

A Transfer agent and custodian fees.

Q What are the other substantial elements?

A Oh, they are all sort of relatively minor but, state taxes, blue sky expenses of qualifying shares in many different states, the expenses of putting out proxy statements, annual and quarterly reports, postage in connection with mailing those things out.

Q Well, you mentioned transfer agent fees. What affects transfer agent fees?

A What affects them?

Q Yes. What is it that makes it go up or down?

A The number of shareholders is probably the principal item that can do that because that's the function, that is, transferring the shares ownership of the individual shareholders.

Q Is there any charge fpr each shareholder?

A Yes.

Q Who is the transfer agent for American Investors Fund?

A The Bank of New York.

Q Do you happen to know what that charge is per shareholder account?

A It is right close to $6 per account.

Q And would that $6 include anything other than the transfer agent fee or is that just the transfer agent

fee would?

A Yes, sure. That would include any expenses connected with sending out reports to each shareholder; expenses of proxy solicitations, and annual meeting expenses, and I would say the bulk of that expense though has got to do with the various things mailed to shareholders at periodic intervals and paying out dividends.

Q In connection with the expenses paid by the Fund, what consideration has been given by the board to methods of minimizing such expenses?

A Well, we have always tried to keep the expenses as moderate as possible, and particularly since the advent of the overall limitation, when it became more and more apparent that we were crowding against that limitation figure, we have made increasing efforts to determine how we could minimize those expenses still further, and one of the things we have done is to, for example, discontinue the use of color in our quarterly reports, and not make them so nice looking, cut down the number of pages. We used to have six pages and we cut it down to four and left out all non-essential items. Instead of using the standard New York City typesetters and legal printers, we began setting the type in our own shop at Chestnutt Corporation's expense so that it wouldn't add to the firm's expense.

All of these things were things that we could effectuate because some of the people that did it are on a salary and it was a matter, if you are going to pay the guy's salary anyway you might as well put him on the Fund's work so we made a more considered effort as we saw the expenses skyrocketing over the course of the past several years and reflecting primarily the increased rate of inflation.

Q At the time of the issuance of the proxy statement which is the subject matter of this action, in 1973, will you describe how that proxy statement came to be issued with the proposed amendment to the advisory contract?

A Well, it is standard procedure, prior to every annual meeting, to get out a proxy statement which furnishes all the essential information that the shareholders should have in order to make a proper judgment on the items to be voted. Such a proxy statement, of course, gives all the experience of the directors, who they are, and gives a copy of the proposed Investment Advisory Agreement, and a description of all matters of litigation, and the amount of brokerage fees that are paid by the Fund, and quite a voluminous amount of information that winds up with a balance sheet of the advisory corporation.

Q Is there any requirement that the income statement

of the advisory corporation be set forth in the proxy statement?

A No.

MR. LITOWITZ: I object.

THE COURT: I fail to see the relevance of that.

MR. LEE: Very well.

Q In connection with the board's consideration of the proposed new Advisory Agreement, can you describe how that was brought before the board?

A It is customary every year along in about May, to begin consideration of a new Investment Advisory Agreement because at that time it is necessary to begin work on the proxy statement and to fix the day of the annual meeting and send out the proxies, and it is normal to call a meeting at about that time of the year, every year, and consider what will be taken up at the annual meeting.

Q But what was the nature of the discussion of the board of directors with respect to a proposed new Advisory Agreement?

MR. LITOWITZ: Can we set a specific date?

THE COURT: Yes.

MR. LEE: Very well.

Q There were two meetings which were considered: the first was May 21, 1973. Can you describe that meeting?

A All of the directors were present, and we were on the subject, somehow, of the expense limitation, and while we were on the subject, I sort of grabbed the ball without having made any previous intention of bringing it up, but I got to thinking about it, and as I thought about it, I thought "Is there any way that we should consider eliminating that feature of it, and I told the other directors why I thought that it was a bad feature. Primarily, what I outlined to them was the fact that the expenses were pretty much out of hand, and going up, and we have just been notified that the expenses, that the postage was going to make a 25 per cent increase, and we were at the moment in a declining market which was taking away some of the Fund assets, and although I currently thought that we were near the bottom, I explained to him that I had no way of knowing for sure that we were near the bottom and that if we continued on for several more years like we were going then, 1929, 1932 style, that inevitably there would come a point when there wouldn't be enough assets in Chestnutt Corporation for it to continue subsidizing a thing the size of a fund. By subsidizing I mean underwriting its expenses to the extent that they might go over 1 per cent.And I pointed outwhat I considered was an unfair situation, that a small entity such as Chestnutt Corporation should underwrite the expenses of a

very much larger entity such as American Investors Fund.

And I, at that time, asked counsel whether we had to more or less stay with that or should we not exercise our prerogative under the undertaking in California, giving them their 90 days' notice and getting out of this situation, and it was pointed out to me by counsel that it wasn't that simple, that it was also in the Advisory Agreement and that therefore while we could give the appropriate notice to the State of California, that we would also have to get it as a change in the Advisory Agreement.

There was a discussion by a number of the other directors on the subject, and at that meeting it was decided that it would be referred to counsel to examine the ways and means and the practicality of getting out of that 1 per cent limitation.

Q Was any action taken with respect to the Advisory Agreement at the May 21st meeting?

A No. It was agreed that particularly the outside directors would gather up the information that they should have in order to make an intelligent judgment on the proposed action and at the same time the counsel for the Fund was going to find out the ways and means and practicalities and draft a proposed new agreement.

Q Was that done?

A Yes, it was. And that proposed new agreement was submitted at the next meeting, which took place about two or three weeks later.

Q In the meantime, was there any contact had with the State of California?

A Yes.

THE COURT: What possible difference could that make?

MR. LEE: As bearing upon the reasonableness of the directors' actions in electing either to stay in the state or to get out of the state.

THE COURT: Do I understand they got out of the state? I thought the witness said the California rules were changed?

MR. LEE: The California rules were changed but in connection with whatever position the State of California might take.

THE COURT: All right, I will take it. Did they in fact get out of California?

MR. LEE: They never formally got out, no, your Honor.

THE COURT: All right, I will take it but it seems a little bit removed from the issues.

MR. LEE: Well, I will leave it at that point.

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Q Mr. Chestnutt, you mentioned your opinion as to the stock market at or about that time.

MR. LEE: I ask that this be marked Defendant's Exhibit F for identification.

(Defendant's Exhibit F was marked for identification.)

xx

Q I show you Defendant's Exhibit F for identification, Mr. Chestnutt, and ask you what that is.

A This is a copy of our weekly market letter signed by me as of May 16, 1973.

MR. LEE: I offer it in evidence.

MR. LITOWITZ: No objection.

THE COURT: I take it he communicated the substance of his opinion there to each of the directors, is that correct?

MR. LEE: No, your Honor. This was sent to the subscribers.

THE COURT: Yes, but don't I understand--

MR. LEE: Yes, the directors get it as well, yes, as a matter of course.

THE COURT: Received since there is no objection.

(Defendant's Exhibit F for identification was received in evidence.)

xx

MR. LEE: No further questions.

CROSS-EXAMINATION

BY MR. LITOWITZ:

Q Mr. Chestnutt, you made reference to referring the matter to counsel when you were discussing the new Advisory Agreement in the summer of 1973. Can you identify that counsel?

A There were present at that meeting counsel in two forms: Mr. Doug Cram and Mr. Clendon Lee.

Q So when you said that you referred certain of the issues to counsel, you referred those issues to both Mr. Lee and Mr. Cram?

A Right.

Q Was there a discussion --

THE COURT: Just a moment.

(Pause.)

Q Mr. Chestnutt, you referred or made the statement that at the May 21st meeting, which was the first of the two meetings at which the expense limitation was discussed, that you sort of grabbed the ball and ran with it on the issue.

Did you discuss at this first meeting exercising Chestnutt Corporation's 60-day right to terminate the agreement?

A No.

Q Did you consider this prior to the meeting of May 21, 1973?

A No.

THE COURT: Consider what?

MR. LITOWITZ: Terminating the agreement on 60 days' notice.

Q You didn't consider that?

A May I explain why I didn't even think of doing that?

THE COURT: No. Don't volunteer. This is your principal client, isn't it, this fund?

THE WITNESS: Right.

THE COURT: All right, let's go ahead.

Q In discussing the change in the expense limitation, did you discuss with Mr. Lee or Mr. Cram the possibility of maintaining the 1 per cent for the additional year in which it would have been in effect anyway and having the new Advisory Agreement having a 1 per cent expense limitation for one year and then go to 1-1/2 per cent for the second year of the contract?

A We have never seriously considered --

THE COURT: The question is did you discuss it. Yes or no. Who did you ask him whether he discussed it with?

MR. LEE: Mr. Cram or Mr. Lee.

A No, I didn't discuss that point with them.

Q Did you give any thought to entering into such a contract that would give the Fund the benefit of the 1 per cent

for the additional year that I would have had anyway and then increasing it to 1-1/2 per cent for the second year?

A No, I never gave it any particular thought at all because in the first place I didn't think that within that period of time there was much chance of it going over 1 per cent anyway.

Q Does that mean you thought it was more or less an academic thing, the 1 per cent for that year?

A No, sir. I don't think it was academic. I thought it was a time bomb sitting in that thing and it should be removed because somewhere down the road it was, maybe, going to explode and bite us.

Q Did anyone discuss, since the Fund reviewed the contract every year, that at the next year's meeting, when the present contract would have terminated away, that being the summer of '74, that that would be an appropriate time to consider raising the expense limitation?

A This is what I wanted to explain before and I was not allowed to, but I think I should be allowed to now.

THE COURT: Well, don't volunteer information. One moment, please. Your attorney will have a chance to examine you further, and if he asks a question which you can honestly answer yes or no, which it would seem to me fits this question, then you do, but don't volunteer the information.

(Question read.)

A There are other reasons for having our advisory contract renewed every year.

THE COURT: What he is really asking you is whether or not that subject that he referred to was discussed by anybody at or about that time. And I would think you could tell him "Yes, it was discussed," or "No, it was not discussed."

A I don't recall a specific discussion at that particular meeting although it has been discussed many, many times and I am sure that the directors are familiar with the reasons for having the agreement voted on every year and not every two years.

Q Did the directors seem to understand that the 1 per cent expense limitation was of benefit to the Fund?

A I don't understand it as being a benefit to the Fund and I would doubt very much that any of the others thought it was a fund to the Fund other than the ability to continue selling in the State of California.

Q Was it your understanding that a rebate could be paid or would be required to be repaid to the Fund from Chestnutt if the expense limitationwere exceeded?

A I understand that, yes.

Q Wouldn't that rebate be a benefit to the Fund in

that they would receive cash?

A I don't believe it would.

Q I believe you testified that in 1964, in mid-term of a previous agreement, that the fee was decreased, is that correct?

A May I have the question repeated, please?

(Question read.)

A That's correct.

Q And that was the time that the fee was decreased from the flat 1 per cent to .8 of a per cent?

A Starting at .8 and going on down to 6/10, and then 4/10, and then 3½/10, and so on, yes.

Q That was done in mid-term and Chestnutt Corporation agreed to such a change?

A That's right. We could have left it for another year but we always took it up every year.

Q You viewed Chestnutt Corporation as bound under this two-year agreement, did you?

A No. Not bound to it, that is locked into it. Absolutely no. There was a 60-day notification privilege by both the Fund and Chestnutt Corporation and furthermore it comes up every year and I think if the same thing came up right again next year I would probably be able to persuade the shareholders to go along with pretty much anything

reasonable that we recommended or suggested to them.

I haven't had any trouble so far in getting an affirmative vote from the shareholders when I wanted it.

MR. LITOWITZ: May I mark for identification as Exhibit 37, the American Investments funding, notice and proxy statement dated June 24, 1974.

(Plaintiff's Exhibit 37 was marked for identification.)

xx

MR. LITOWITZ: I offer Exhibit 37 into evidence.

Any objection, Mr. Lee?

MR. LEE: No.

THE COURT: Received in evidence.

xx

(Plaintiff's Exhibit 37 received in evidence.)

Q Mr. Chestnutt, I call your attention to page 4 of Exhibit 37, and call your attention to the first full paragraph on page 4, toward the middle of the page, beginning after the heading "Information pertaining to manager-adviser and present Investment Advisory Agreement."

A Yes.

Q Did you review Exhibit 37 before it was sent out to the shareholders?

A Sorry?

Q Did you review Exhibit 37 before it was sent out to the shareholders?

A Yes.

Q Now, at the point on page 4 to which I just referred you, is there reference there to this present lawsuit?

A Reference thereto?

Q This lawsuit.

THE COURT: Does it refer to this particular lawsuit there.

A I don't -- let me see it.

THE COURT: Could we have a concession on this?

A I haven't found it in this paragraph but I do know there is a reference somewhere to this being used as a defense in another lawsuit. Is that what you are referring to?

Q No. This sentence here.

THE COURT: Perhaps we can get a concession for the record.

MR. LEE: Yes. It refers to the Galfand suit in Philadelphia.

THE COURT: That's this case?

MR. LEE: Yes.

THE COURT: All right.

Q Now, the sixth line of that sentence reads "Which action is believed to be moot although technically still

pending."

A Yes.

Q Did you review that sentence in the proxy statement before it went out?

A Did I what?

Q Did you review this proxy statement?

A Yes.

Q Did you believe this action was moot when the proxy statement was moot?

THE COURT: What difference could it possibly make whether he believed it was moot or not? The case is here on its merits and it is being tried. I don't see that his belief that it was moot has anything to do with any issue before me.

MR. LEE: Your Honor willrecall that the actual complaint here was dismissed by your Honor.

THE COURT: Well, I didn't know what the time sequence was.

MR. LEE: Yes, following this.

THE COURT: I don't see that his state of mind in believing the case was moot has anything to do with it. That's the difficulty I have with this line of inquiry. I have to decide whether it is moot or not.

Let's go on to something else.

MR. LITOWITZ: No further questions.

ebh

THE COURT: Is there anything further from Mr. Chestnutt?

MR. LEE: No further questions, your Honor.

THE COURT: All right, you may step down.

(Witness excused.)

MR. LEE: Your Honor, I have one further witness, namely Mr. Currier, an outside director, and he is the gentleman I referred to as being on tap tomorrow morning.

THE COURT: And you will have him here at 11 o'clock?

MR. LEE: Yes.

THE COURT: Try to get here a little earlier in case we can get our time organized a little better.

MR. LITOWITZ: Your Honor, do you want us to hang on to the exhibits?

THE COURT: I think so.

MR. LITOWITZ: And you mentioned that there is, other than Exhibit 1, was there a problem with another exhibit that was not readable?

THE COURT: Well, there is. I think it is is 14A.

MR. LITOWITZ: Well, 14B is really a typed version of 14A.

THE COURT: I didn't so understand it but if it is, that's sufficient.

MR. LITOWITZ: Yes, your Honor.

THE COURT: Yes, I think you should all keep your own exhibits until the matter is fully submitted. Sometimes it is helpful to look at some of them while the witness is testifying.

All right, we will be in recess until tomorrow.

(Discussion off the record.)

(Adjourned to Wednesday, February 19, 1975, at 11 A.M.)

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MILDRED GALFAND,

Plaintiff

-against- 73 Civil 3849

George A. Chestnutt, Jr.,

Defendant.

February 19, 1975

Trial resumed.

Present: All counsel.

THE COURT: You may proceed.

MR. LEE: Thank you, your Honor.

One of the exhibits which was marked at one of the depositions, Defendant's Exhibit A for identification at the deposition, is a letter of transmittal from the Investment Company Institute dated June 22nd, 1973 to its members annexing a copy of a report entitled "An Analysis of Factors Influencing Mutual Fund Expense Ratios" dated May 17th, 1973.

The letter of transmittal states that it was transmitted to the Commissioner of Corporations of the State of California at his request.

Now, I have shown this copy to Mr. Litowitz and he has no objection to its authenticity.

I offer it in evidence and I understand that he objects to its admissibility.

emb 2

MR. LITOWITZ: Your Honor, what I do stipulate to is that the exhibit Mr. Lee has proffered is a copy and is the same as the exhibit that was used on the depositions.

The basis for my objection is that the transmittal letter is dated June 22nd, 1973, which is presumably the earliest possible date this thing was put into the main stream for distribution.

THE COURT: Could we have the reference to it in the deposition?

MR. LEE: It is referred to in the deposition of Mr. Greene.

THE COURT: Would you hand that deposition up, please?

(Pause.)

THE COURT: I think the issue will have to be resolved by reference to Mr. Greene's testimony. If Mr. Greene testified that this memoranda sets forth information which was known to him at a relevant date--

MR. LEE: He testified, your Honor, if I recall correctly, that he knew that the study was in the course of preparation; it was the subject of discussions that he had with the No-Load Fund Committee of the Investment Company Institute. As it shows on its face, it was not completed until May 17th. We didn't have a copy of it until June.

emb 3

THE COURT: What is it offered to show?

MR. LEE: It is offered to show that this was a matter of considerable concern to investment companies, and its analysis of the cost factors ultimately comes down to the conclusion that it is the number of small shareholders which bears most directly and importantly on the expenses of the investment company.

THE COURT: It seems to me that that is a fact as to which, in the first place, there is other evidence already in the record; is that correct?

MR. LEE: That is correct.

THE COURT: And secondly, most anyone could probably reach that conclusion by a process of reasoning, I should think.

It must be obvious that there are some costs which are related directly to the number of shareholder accounts rather than to the dollar value of the portfolio. Isn't that obvious to everybody?

MR. LITOWITZ: I think it may be obvious if those facts are factors that were addressed to the attention of anyone.

THE COURT: Don't you think anyone in this business could reach that conclusion, particularly if he knows what the nature of his mailing costs are, which are on an

emb 4

account number basis? Some of it is transfer agent services, such as dividend disbursing, and so forth, and is directly cost-related to the number of accounts.

You could have a mutual fund with 11 people in it and they could have a portfolio of this size and its expenses would be minimal.

MR. LEE: That is exactly the point. We don't offer it for the truth of the monumental data asserted therein, and we don't suggest that the Court be required to read it.

THE COURT: And you don't say that he relied on it either.

MR. LEE: He did not rely on it but he knew of its being in the course of preparation.

THE COURT: And he knew what it would show, too, didn't he?

MR. LEE: Yes.

MR. LITOWITZ: In fact, there was a brief on behalf of the funds to try to get the thing raised.

If Mr. Lee will stipulate that it was neither read nor considered by any director prior to the approval of the new contract--

MR. LEE: I so stipulate.

THE COURT: All right. I will take it

emb 5

based on your stipulation. The objection is withdrawn and it is taken on the basis of the stipulation.

MR. LEE: Thank you, your Honor.

MR. LITOWITZ: It will save Mr. Lee the trouble of writing a long brief. Part of his brief has already been written.

(Defendant's Exhibit A for identification was received in evidence.)

MR. LEE: I wouldn't inflict that on the Court, your Honor.

I offer as Defendant's Exhibit G the deposition of the plaintiff, Mildred Galfand.

MR. LITOWITZ: There is no objection to that, your Honor.

THE COURT: All right. It is received in evidence.

(Defendant's Exhibit G for identification was received in evidence.)

MR. LEE: I will call John Currier.

J O H N C U R R I E R, called as a witness by the defendant, being first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LEE:

Q Mr. Currier, what is your occupation?

A President of the Women's Division of Cluett, Peabody & Company.

Q How many plants are in the division?

A 11.

Q How long have you been president of the Women's Division of Cluett, Peabody?

A One year.

Q During the course of your being president of that division, what have been the maximum number of employees, would you estimate?

MR. LITOWITZ: I object, your Honor.

THE COURT: How many people do you supervize? Is that what you want to know?

MR. LEE: Yes.

THE COURT: I will take how many people he supervizes; how many people he is responsible for.

Q Do you supervise the employees of that division?

A I supervise the management group that supervizes directly 4500 people.

Q Would you outline your education, please, Mr. Currier?

A Penn State, AB degree; Harvard Business School, MBA degree.

Q Would you please state briefly your employment since you completed your Master's degree at the Harvard Business School?

A Assistant controller of Wells Fargo, 1946; assistant controller-personnel manager, Maiden-Form, '46-50; salesman for Textron, Inc., '50-52; returned to Maiden-Form as general sales manager and later vice-president of sales, '52-67; president of Formfit-Rogers, a division of Genesco, Inc., from '67 until December of '73.

THE COURT: What do they make: the Women's Division of Cluett, Peabody?

THE WITNESS: Arrow shirts for ladies, Van Realte lingerie, gloves, hosiery, robes, and Wellmode lingerie. Those were the three operating units.

Q Mr. Currier, when did you become a director of American Investors' Fund?

A 1962.

Q Are you presently a director?

A Presently, yes.

Q Do you have any position with Chestnutt Corporation?

A No.

Q Do you own any stock in Chestnutt Corporation?

A Yes, I do.

Q How much in percentage?

A I own 1% or 2000 shares of Chestnutt Corporation. That's the stock.

And I own $2,000 of bonds, which is about 2% of Chestnutt Corporation.

And I own 1100 shares of American Investors Fund.

THE COURT: Is he an outside director?

MR. LEE: Technically, your Honor, he is, under the 1970 amendment to the Act, an "interested person." He is an unaffiliated director by the terms of the statute, but he is an interested person for purposes of the Investment Advisory Agreement.

MR. LITOWITZ: The plaintiff agrees with those two definitions.

THE COURT: All right. Did you ever work for Chestnutt Corporation?

THE WITNESS: No, sir.

BY MR. LEE:

Q When did you acquire your stock interest in Chestnutt Corporation?

A I purchased the stock and the bonds in Chestnutt Corporation in 1964 about half of the total, and in '65

the other half.

Q Did you purchase them or subscribe for those bonds and stock from the corporation itself?

A No. I purchased them from Mrs. Grizelaware.

Q And who is Mrs. Grizelaware?

A She was the mother of a classmate of mine at school.

Q I take it from your answer that you were already a director of the Fund at the time that you purchased from Chestnutt Corporation.

A That is correct.

Q Now, during the course of your business career, have you had occasion to become familiar with costs and profit control?

A Every day.

Q Since you have been on the board of directors of American Investors Fund, what has been the practice with respect to the adoption of Advisory Agreements?

A The Advisory Agreements have been submitted to the shareholders each year, but each Advisory Agreement runs for two years. In effect, it is re-offered for re-affirming. It's been a practice to have it reaffirmed annualy even though it is a two year contract.

Q When you first became a director of American

Investors Fund, what was the rate of the advisory fee?

A 1%.

Q Did there come a time when that rate was changed?

A Yes. We reduced it to a sliding scale based on the volume, starting at 8% for the first 50 million--

Q When you say 8% you mean 8/10?

A 8/10 of a percent. 6/10 for the second 50 million, 4/10 for the next 200, and 3 1/2 for the next 200, and 3/10ths of a per cent over 500,000,000.

Q There are in evidence the minutes of directors' meetings of May 21, 1973 and June 5, 1973; did you attend those meetings?

A The dates again, please?

THE COURT: Do the minutes show that he attended the meetings?

MR. LEE: He attended one meeting but he didn't attend the second meeting.

THE COURT: It is in evidence. You don't have to go into it again.

I assume the minutes are correct, unless there is evidence to the contrary.

MR. LEE: Thank you, your Honor.

Q The minutes of the meeting of May 21st, 1973

emb 11 Currier-direct

to the consideration of Advisory Agreement; do you recall that?

A Yes, I do.

Q Would you state the substance of that consideration?

THE COURT: You mean the substance of the discussion?

MR. LEE: The discussion.

A The discussion centered on whether or not, in that then declining market, and a comparatively high rate of redemptions, whether or not the adviser's responsibility for refunding the Fund, any fee in excess of the 1% was a likelihood, and what the impact of that would be, and ways to face up to the problem.

Q Did you participate in any of that discussion?

A Yes, I did. I had my own worksheet at that meeting and I was sitting next to another director who had his own similar sheet, and we were quite concerned with the impact it would have if there were a change and a declining interest in mutual funds, and specifically ours at that point.

Q I show you Plaintiff's Exhibit 23 and ask you whether--which consists of a letter plus a handwritten piece of paper annexed to it--and ask you whether that

emb 12 Currier-direct

handwritten piece of paper is what you refer to.

A Yes, it does.

Q Mr. Currier, I show you page 27 of your deposition in this case, which has been marked as Plaintiff's Exhibit 35. You will note the word "secret" appears on that page; is that the best recollection that you have of your testimony?

A No. When I read this, it was clear to me that that was supposed to have been "sacred."

MR. LEE: May I, your Honor, for purposes of the record, simply read the answer as the witness has just changed it?

THE COURT: Yes. It is an obvious typographical error, isn't it?

MR. LEE: It could be construed the other way, your Honor.

". . . and the feeling has been that the shareholders should annually reaffirm or have the opportunity to reaffirm the contract. We have not felt there was anything sacred about the two years."

Q Mr. Currier, the record shows that you did not attend the meeting of June 5th at which the proposed Investment Advisory Agreement was approved for submission to the shareholders. Did you thereafter attend the

shareholders' meeting?

A In July? No, sir; not of that year.

MR. LEE: No further questions.

* * * * * * * * * * * * * * * * *

CROSS-EXAMINATION

BY MR. LITOWITZ:

Q Mr. Currier, are you familiar with the form N-1-R that is filed by American Investors' Fund with the SEC?

A Yes.

MR. LITOWITZ: I would like to have marked for identification as Plaintiff's Exhibit 38 a two-page extract from Form N-1-R instructions, and I indicate that on the two pages I am offering there are some handwritten notes which have been put on by myself, and they are not a part of the papers.

THE COURT: What is the document?

MR. LITOWITZ: It is part of the N-1-R instruction form.

THE COURT: What is the purpose of receiving it?

MR. LITOWITZ: I actually have a copy. I want to put the whole form in and--

THE COURT: All right, you may proceed.

MR. LEE: May I see the instructions, please?

emb 14 Currier-cross

(Pause.)

MR. LEE: I take it this consists of just a copy of the Commerce Clearing House pages relating to this?

MR. LITOWITZ: That is exactly right. It is from the CCH Reporter, Volume 3 of the Federal Securities Reports appearing at page 39,837 and page 39,838.

MR. LEE: I will have no objection to the introduction of this into evidence for whatever purpose, but I will object to the examination of the witness in connection with the accounting instructions which--these constitute instructions to the auditors.

THE COURT: Well, if he has any knowledge about the document, he may be examined about it. If he doesn't know anything about it, I'm sure he can tell us.

Have you ever seen this before?

THE WITNESS: The N-1-R? Yes, sir.

MR. LITOWITZ: If there is no objection, I will just offer them into evidence.

THE COURT: Received in evidence without objection.

(Plaintiff's Exhibit 38 for identification was received in evidence.)

Q Mr. Currier, have you ever served as a director of any public corporation?

A No, sir.

Q You mentioned that the discussion on May 21 concerning the Advisory Agreement included a discussion about the declining market. Can you tell us who said what about the declining market at that time?

A I can't remember who said what. The general discussion pointed to the fact that the market was declining and that it was common knowledge. The redemptions were running high, if I recall correctly, not only American Investors but all funds, and other than that, I don't recall anything about the declining market.

Q Did anyone at that meeting discuss the imminence of a rebate by Chestnutt Corporation to the Fund?

A No, not to the best of my knowledge. It was discussed in the framework that here we were, midyear, and if the present trends were to continue, the expenses, which included the management fee, could possibly end up being in excess of 1%.

Q Did you form any judgment yourself as to when that point might arrive?

A No, but I would have to answer by saying it appeared that it could happen any time in the remaining six months of the year that we could reach the point where that became clear.

Well, when you said "it could happen within six months," was that just physical possibility or was that your best estimate of what might happen?

A I couldn't tell for sure where the market was going and where the redemption rates were going but present trends were very clearly pointing in the direction that if sustained, those trends would lead to the possible occasion for a refund or the necessity for a refund because the expenses and the fee could exceed 1%.

Q And if that trend continued, that situation might arise within six months?

A Very clearly, in my judgment.

THE COURT: "Very clearly" what?

THE WITNESS: It could arise, the occurence of that.

Q In 1973 did you have an opinion as to whether the fee paid by American Investors Fund to Chestnutt Corporation was higher than the fees paid by other Mutual funds?

A Oh, I certainly do.

Q What was that opinion?

A That American Investors Fund's fee was higher. It was more than an opinion. It was a fact as witness the worksheets that we used at that time.

emb 17 Currier-Cross

I would hasten to add, however, that the fact that American Investors' fee was higher than other fees in itself never bothered me.

Q Did anyone ever tell you that someone at the Securities and Exchange Commission requested that the proxy statement issued in the summer of 1973 contained a statement that the fee paid by American Investors was higher than that paid by most funds?

A Yes. I was acquainted with that but I don't know just when I became aware of it.

Q You were acquainted with the fact that the SEC had raised the issue?

A That there was a letter from the SEC to Warren Greene, yes, sir.

Q Do you recall when you became familiar with that fact?

A No, I don't.

Q Let me finish my question. Whether it was prior to the institution of this lawsuit?

A I really don't know when I first knew of that.

I was aware that our statement had to--the proxy statement or the prospectus had to state that our fee was higher than--I think the words were "most other funds."

emb 18 Currier-Cross

Q Do you know whether the proxy statement did state that?

A I'm not sure.

Q If you had learned of that letter from the SEC prior to the issuance of the proxy statement would you have taken steps to see that the proxy statement was changed?

A Changed? I have to ask you, in what way?

Q Changed to include such a statement in the prospectus?

A The SEC and our fund have had continual discussions: telephone, letter, and a lot of it is minutiae in terminology, et cetera.

I have to answer your question by saying what the SEC has asked Chestnutt, Greene and Lee to do. I have left it pretty much up to them.

THE COURT: Are you an attorney?

THE WITNESS: No, sir.

Q Do you know whether the disinterested directors ever consulted with their own attorney on any matter relating to the Fund?

A If so, I'm not aware of it.

Q Do you know whether the disinterested directors ever met separately and apart from the rest of the board?

emb 19 Currier-Cross

A Yes, sir, I do.

Q Had they ever so met?

A Yes, sir.

Q Did they meet on the issue of the new Advisory contract in the summer of 1973?

A No, I don't think so. I'm aware of two such meetings but I don't think that that was the subject of either of those meetings.

Q In the summer of 1973 would you have been in favor or were you in favor of increasing the fee payable by American Investors Fund to Chestnutt?

A No, sir.

Q Did you view the change in the expense limitations as an increase in fee from American Investors Fund to Chestnutt?

A No, I didn't. As a matter of fact, I considered that had we raised the fee, that would have been tougher on the shareholders of American Investors Fund than raising the 1% expense for that to 1 1/2 because I felt right along that incentive needed to be kept on Chestnutt to keep the expenses down, not only of American Investors but his own as well.

Q Did you view the threat of the rebate an incentive to Chestnutt to keep the expenses down?

emb 20 Currier-Cross

A I certainly would consider it would be an incentive; yes.

Q And did you view a 1% expense limitation a greater incentive than a 1 1/2 % expense limitation?

A Yes, but by the same token I didn't want to see the advisor, who was synonymous with the Fund in terms of the uniqueness of the Fund, in a position where he couldn't make a reasonable amount of money himself.

Q In the summer of 1973, did you know Mr. Chestnutt's salary?

A I didn't know specifically at that time.

Q Did you have an idea of the approximate range of his salary?

A If I were to guess, it was in the neighborhood of $60,000.

THE COURT: Putting it a little differently. Had you ever requested information from either the Fund's officers or the Chestnutt Corporation which they declined to give you since you have been a director?

THE WITNESS: I have never been denied any information.

THE COURT: That you specifically asked for?

THE WITNESS: And I have specifically asked for some on a number of occasions.

emb 21 Currier-Cross

THE COURT: Does your answer also apply to counsel: that they never rejected a request of yours for information?

THE WITNESS: No, sir. I have always found any answers to be direct.

BY MR. LEE:

Q Did you consider, in the summer of 1973, the expense limitation to be a benefit to American Investors Fund?

A A benefit?

Q Yes.

A Well, I would think any limitation is a good thing for the person who can be disbenefited if there is no limitation. I think a limit is a good thing, whether it is 1 or 1 1/2.

Q In May of 1973, did you have any information of the ability of Chestnutt Corporation to remain solvent and able to perform?

A Yes, I did.

Q You were concerned about Chestnutt Corporation's solvency, is that correct?

A Maybe solvency is too strong a word.

I was talking to Chestnutt on a number of occasions that I wanted to see his staff cut so that his

expense requirements were in keeping with the times, and when a business grows, you hire people on most occasions; when it declines, you cut people off the payroll. And I felt very strongly that he should gear his outlays as expenses for the Fund, and his own needs to the requirements at the moment. And he responded and substantial cuts were made. I think it is too strong to say that a -- well, Chestnutt would become insolvent.

My first obligation, I felt, was always to the shareholders, but by the same token, if the advisor doesn't have a viable business, where are the shareholders going to be in a case like American Investors Fund?

Q Did you feel that Chestnutt could become "unviable"?

A I think any business could and I think he could have; yes.

Q You thought there was a clear imminent danger of that happening to Chestnutt in May of 1973?

A I have to answer that by saying that we had another problem. The Fund had started on the premise that anybody could send in a buck and become a shareholder of American Investors Fund.

I wasn't aware that any other fund invited small guy the way we did. That was costing us an arm and

a leg. At that time the postage was 8¢ going to 10. It had gone from 6 or whatever it was before 8, fairly recently before, and we had shareholders far too many in terms of number, in terms of what it was costing us to do business.

So we finally got around to changing that since then and put limits on it, and that will help the expenses.

Q Did the Fund welcome the small shareholders in the summer of 1972 and the year prior?

MR. LEE: Will you repeat the date please, Mr. Litowitz?

MR. LITOWITZ: The summer of 1972 and the years prior.

A Well, we are talking about December of '73; aren't we?

Q Up to now we have been talking about '73. What I am asking you is did anything happen from the summer of 1972 to the summer of 1973 to make you change your mind about the 1% limitation?

A I think we changed the limit of the minimum purchase on or about '72 to reduce the number of incoming small shareholders which, again, was a huge expense to us. I am not sure of the date but I think it was prior to the period of '73 we are talking about.

emb 24 Currier-cross/redirect

MR. LITOWITZ: I have no further questions, your Honor.

THE COURT: Any redirect?

MR. LEE: Just very briefly, your Honor.

* * * * * * * * * * * * * * * * *

REDIRECT EXAMINATION

BY MR. LEE:

Q Mr. Currier, there is in evidence a letter from Mr. Cram dated May 15, 1973 transmitting a copy of the Fundscope Annual to each director.

Now, I do not have a 1973 Fundscope here; I have a 1974 one. I hand you this volume and ask you if this is substantially the same type of size and compendium--and this is more than the Court would ever want to know; it's like a telephone book--but I simply want to exhibit it physically before the court and have you testify as to what it is.

THE COURT: It is a publication of general acceptance, isn't it, in the industry?

MR. LEE: Yes, your Honor. And it is not simply a magazine; it's frightful.

THE COURT: Well, I don't know whether it's frightful or not.

MR. LEE: No further questions.

emb 25

MR. LITOWITZ: No questions.

(Witness excused.)

MR. LITOWITZ: Your Honor, I have just this one thing. Mr. Semmes is in Florida and has just gotten back from an extended stay in Kuwait where he is a consultant, and I accordingly will not call Mr. Semmes, and we will rely solely on his deposition, which is in evidence.

That concludes our defense.

THE COURT: Now, as a practicing lawyer, I represented Mr. Semmes' landlord. Mr. Semmes used to be in the automobile business in--

MR. LEE: In Scarsdale; yes.

THE COURT: He was the plaintiff in a famous case in this Circuit called Semmes Motors against Ford.

MR. LEE: Yes, your Honor.

THE COURT: All right. Are you resting, Mr. Lee?

MR. LEE: I rest.

MR. LITOWITZ: The plaintiff has nothing further, your Honor.

THE COURT: I would like to take one matter up with you just for my own clarification.

I haven't read all of the exhibits, and that is by my own choice because I won't get to the matter until it is fully submitted.

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I have page 4 of Mr. Lee's pre-trial memorandum, and there is a discussion here of de minimis. Now, there seems to be no de minimis in the federal court. The more trivial a case is, the more judicial attention it occupies. I am not suggesting that this one is trivial, but I find the use of the words "de minimis" in connection with a fiduciary obligation a little bit unfounded.

I would like to know exactly what is contended to be de minimis. What are we talking about here in terms of money? This has to do with 1973, and there was some testimony I heard earlier to the effect that there was some interest and some taxes to be excluded from an expense figure.

The trial memorandum tells me about $7500 direct costs for Philadelphia counsel. Idon't know if that is in the record or not, but I think you ought to straighten out that entire statement there on page 4, unless it is clarified in the exhibits.

MR. LEE: Thank you, your Honor. I think that I can straighten it out by taking the testimony of Mr. Mumbach and getting the exact amount of the interest and taxes.

THE COURT: That he gave me, and I take it that that come off the $1,694,418?

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MR. LEE: It does, your Honor.

THE COURT: And then you have 75 for Philadelphia counsel. Is that in the record somewhere?

MR. LITOWITZ: I think it is.

MR. LEE: It may be in Mr. Mumbach's testimony. I don't know. I could have it prepared on a schedule.

THE COURT: Do the three of these items bring you below the 1% by your computations?

MR. LEE: No, not quite below it, your Honor.

THE COURT: I would say to you that you better get below it because I think when you have a fiduciary obligation, even 35 cents is not de minimis.

MR. LEE: Well, that raises, I believe, the basic concept here of the new fiduciary obligation which the Congress has placed here on the burden of proof.

It is our contention that they must show that the action was unreasonable.

I understand your Honor's point about the "any quantum whatever," and if I may, I will prepare a shcedule, and if it is not satisfactory to Mr. Litowitz, we will put Mr. Mumbach back on the stand at some point with respect to it.

THE COURT: I don't think we are here to deal with trivial issues. I believe that Mr. Litowitz is

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proceeding on a different theory of computation. He is treating the meaning of a "year" differently, and of copurse that is a question for the Court to resolve on the entire record.

I understand that his theory is different from yours with respect to the appropriate period or which figures are applicable.

All right, I will take the matter as fully submitted.

Could the record be clarified as to that counsel fee? Do you doubt the truthfulness of that figure?

MR. LITOWITZ: If Imay, I believe Mr. Lee, who was deposed in this action, testified to that while having some figures in front of him, which I assume came--

MR. LEE: I think that is true. I will rely for that on what I have in my deposition, your Honor.

THE COURT: You understand, I haven't read all the depositions because I would rather take it in one single piece.

Now may I go off the record with you gentlemen and discuss the time limit for post-trial memoranda.

(Discussion off the record.)

THE COURT: Within 30 days from your receipt of the transcript you are to exchange your post-trial

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memoranda, and anyone wishing to reply may reply within 10 days. No new matter is to be contained in the replies.

At that time, will you please submit the exhibits to the Court with a letter of transmittal in duplicate.

I will mark it "Fully submitted. Decision reserved.

MR. LEE: Thank you, your Honor.

MR. LITOWITZ: Thank you, your Honor.

Would you require us to submit proposed findings?

THE COURT: You may but I don't insist on them.

MR. LEE: I didn't hear Mr. Litowitz' question.

THE COURT: He asked whether I required proposed findings and I said that I don't insist on them. If someone thinks it will be helpful and want to submit them, he may.

We have got a pretty good pre-trial order here so I won't insist on any form of findings. If someone wants to put them in, I will take them, but I don't think it is essential. You might as well simplify it for yourselves.

All right, thank you, gentlemen. I appreciate your cooperation in assisting in the completion of this matter.

The decision is reserved.

(Trial concluded.)

WITNESS INDEX

Name	Direct	Cross	Redirect	Recross
Douglas H. Ginn	4	31	43	
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George A. Chestnutt	61	69		
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Frank G. Fowler	70	78 q		
Eugene A. Ulrich	80	90	95	
Peter G. Nunbach	99	118	125	127
John Currier	162	169	180	

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Defendant	Identification	In Evidence
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D	101	101
E	108	114
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Service of 1 copies of this within
Appendix is admitted this
7 day of August 1976.
Kunstler & Kunstler
Edward A. Greenspan
ATTORNEYS FOR Plaintiff and Cross-Appellant

BEST COPY AVAILABLE